Electricity and gas supply network unbundling in Germany, Great Britain and The Netherlands and the law of the European Union

Ehlers, E.M.

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ELECTRICITY AND GAS SUPPLY NETWORK UNBUNDLING IN GERMANY, GREAT BRITAIN AND THE NETHERLANDS AND THE LAW OF THE EUROPEAN UNION: A COMPARISON

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ELECTRICITY AND GAS SUPPLY NETWORK UNBUNDLING IN GERMANY, GREAT BRITAIN AND THE NETHERLANDS AND THE LAW OF THE EUROPEAN UNION: A COMPARISON

ONTVLECHTING VAN GAS- EN ELEKTRICITEITS-LEVERINGSNETWERKEN IN DUITSLAND, GROOT-BRITTANNIË EN NEDERLAND EN HET RECHT VAN DE EUROPESE UNIE: EEN VERGELIJKING

Proefschrift

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op gezag van de rector magnificus, prof. dr. Ph. Eijlander,
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door het college voor promoties aangewezen commissie

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Promotores

Prof. dr. L. Hancher
Prof. dr. P. Larouche

Promotiecommissie

Prof. dr. G. Brunekreeft
Prof. dr. J.-C. Pielow
Dr. B.R.R. Willems

Electricity and Gas Supply Network Undbundling in Germany, Great Britain and The Netherlands and the Law of the European Union: A Comparison
Eckart Ehlers

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To my family
my wife Conny, my father († 10/09/2009) and mother and my brother Jörg
for their endless support and unshakable confidence

PREFACE

The idea of writing a PhD thesis on this subject emerged both from my experience in the area of corporate restructuring and from the debate that took place in Germany following the entry-into-force of the second generation of internal energy market legislation in summer 2003. In the ensuing quest to find top class supervision, it was a great honour and pleasure to be accepted by Professor Leigh Hancher. She not only managed to set (and keep) this work on track with her uniquely unflappable and cheerful attitude; the progress of the work also benefited immensely from her sharp mind and generous forbearance in leaving me room to develop my ideas even if they varied from her own opinion.

This work, however, would not have flourished without both the excellent *infra*structure and research conditions of Universiteit van Tilburg and the supportiveness of its people, in particular of the Department of European and International Public Law at the Faculty of Law and of the Tilburg Law and Economics Center TILEC. In this context, I am greatly indebted to my second supervisor Professor Pierre Larouche for his guidance on academic analysis, his availability to discuss matters and his general support, not to mention his endless patience. I also wish to express my deepest gratitude and respect to Professor Willem van Genugten and Professor Eric van Damme for their interest, generosity and open-mindedness, and for their warm reception.

A special role in this PhD research was played by Professor Gert Brunekreeft whom I was privileged to meet when I arrived in Tilburg in autumn 2004 and who has become a mentor and friend. Thanks to him, this work became part of the interdisciplinary and international project UNECOM (www.unecom.de), which he initiated soon after becoming Professor of Energy Economics at Jacobs University Bremen. As a result, I moved to the Institute of Energy and Mining Law at the Ruhr-Universität Bochum headed by Professor Johann-Christian Pielow where I participated in the UNECOM project as a researcher until leaving Bochum at the end of June 2009, and I would like to express my sincere gratitude to him for what was, for me, two years of rewarding and fruitful collaboration on this project.

Special mention and thanks go to Jeroen Denkers who had to put up with me in the same office for more than two and a half years, for his open-mindedness and never-ending support, to Sophie van Bijsterveld for her interest in my work and

patient explanations of Dutch constitutional law, and to Aukje van Hoek. In Bochum, I could not have succeeded without the general legal expertise and permanent readiness for discussion of Christian Schimansky, the collegiality and vivacity of Sindy Güneysu and the much appreciated support of Jacopo Rossi.

Without Mark Pakenham, a friend and former colleague of mine whilst working in the UK, and his selfless support and very English articulacy, this work would be of substantially lesser linguistic quality.

Last but not least, this PhD thesis has substantially benefitted from the financial support of the Dutch foundation Next Generation *Infra*structures in Delft and the industry co-sponsors of UNECOM. A significant financial contribution by the Institut d'Études Juridiques Européennes of the Université de Liège is also gratefully acknowledged.

Hannover/Karlsruhe, November 2009

Eckart Ehlers

EXECUTIVE SUMMARY

This work analyzes the legitimacy of energy supply network unbundling measures exceeding the current legal unbundling requirements) as threatened or proposed by the European Commission on the basis of European economic regulation competences.

Apart from threatening to order the divestiture of energy networks of individual vertically integrated energy supply undertakings, the Commission originally proposed to either impose energy transmission network ownership unbundling (OU) or "deep" independent system operation ("deep" ISO), which would give independent energy transmission system operators exclusive investment decision and commissioning powers.

In addition, the current draft Electricity and Gas Directives contain as a third option the implementation of independent transmission operators (ITOs). Because this option is merely a stricter form of legal unbundling, it is not the subject of the analysis here as to what extent the further legislative unbundling measures OU and "deep" ISO are in breach of economic fundamental rights as protected in Germany, Great Britain, the Netherlands and the European Union.

A. EC competences in competition law and sector regulation

Ordering the divestiture of individual vertically integrated energy supply networks on the basis of the Commission's competition law enforcement powers would be disproportionate to the objective sought, which is to restore competition in an internal energy supply market. Legal ownership unbundling or divestiture and "deep" independent system operation of energy supply networks would, if at all, only be of marginal benefit to consumer welfare. For electricity, the benefit largely depends on the existence of sufficient generation. With respect to gas, it is shown that regulation in tandem with competition law enforcement suffices.

With regard to EC legislation, assuming that it was in principle legitimately based on the harmonization competence of Article 95 EC to introduce further unbundling measures as originally proposed by the Commission, the EC legislature would in fact not be allowed to exercise this competence for several reasons. The primary reason is that this would be a breach of Article 295 EC because the EU is not competent to legislate in the area of property ownership

allocation. Further, the fundamental freedom of the free movement of capital according to Article 56 EC would be compromised because the current draft Directives in prohibiting vertically integrated energy production and supply undertakings of one Member State from investing into ownership unbundled energy transmission network operators of other Member States cannot be justified with public policy and security reasons or overriding interests.

B. Evolution of energy supply sectors in Germany, Great Britain and the Netherlands

The energy supply sectors in Germany, Great Britain and the Netherlands have developed rather distinctly and display rather diverging stages of energy network unbundling.

The Netherlands are and remain a natural gas exporting country for the time being. The Dutch energy supply industry has always been (predominantly) state-owned (i.e. including municipalities and provinces); all energy networks are state-owned and as such subject to regulation. New legislation has recently been passed ensuring that this remains the case for the time being.

The UK has only recently turned from a natural gas exporting to an importing country. The energy supply industry in England, Wales and Scotland (Great Britain) is equipped with sufficient electricity generation and was privatized some two decades ago, the electricity sector in England and Wales vertically separated *ab initio* (at least with respect to transmission) and the gas sector in Great Britain vertically integrated but separated voluntarily about a decade after privatization. A great deal of work was needed before regulation began to work effectively (in particular in the gas sector but also in electricity wholesale). Since privatization, it has not forced further unbundling upon its energy sector except for creating an independent GB electricity transmission system operator with some influence on investment.

Germany, which has never possessed significant natural gas resources, has always been heavily reliant on coal as primary energy source. Germany's energy supply sector has always been in private hands or in the hands of municipalities, which enjoy a certain degree of autonomy as a result of Germany's federal structure. Liberalization has taken almost a decade culminating in the late introduction of a sector-specific regulatory authority in July 2005, which has made considerable progress ever since (with incentive regulation introduced in 2009).

C. Constitutional law and fundamental rights protection

The different developments in market structure are also a consequence of the contrasting constitutional settings of Germany, the UK and the Netherlands and the differences in fundamental rights protection.

In the UK and the Netherlands, the European Convention of Human Rights (ECHR) is in principle *the* fundamental rights standard, against which national legislation is to be measured. In the UK and the Netherlands directly applicable EC legislation is to be measured against EC fundamental rights.

In the UK the ECHR is only (to a limited extent) applicable via the Human Rights Act 1998 whereas in the Netherlands the ECHR is part of the national legal order as is, in principle, EC law.

In Germany, national legislation is measured against the requirements of the German Constitution; directly applicable EC legislation as well as EC Directives are not measured against German constitutional law as long as they live up to a similar fundamental rights standard as is afforded by the German Constitution.

In the UK, the doctrine of parliamentary sovereignty has historically led to the submission of the judiciary to Parliament to the extent that Acts of Parliament are not reviewed under English law. A further consequence of this doctrine is the acceptance that fundamental rights have always been subject to unfettered interference by Parliament normally based on political bargaining. This constitutional setting has certainly been conducive to the success of UK style energy supply sector regulation.

In Germany, the Federal Constitutional Court *Bundesverfassungsgericht*, which safeguards the German Constitution and thus also reviews Acts of Parliament, has developed and enforced a rather detailed fundamental rights protection, which directly influences German style (energy supply) sector specific regulation, which focuses stricter on the rule of law than on regulatory bargaining.

The Netherlands finds itself positioned half-way between the UK and Germany in that national legislation can also be reviewed albeit only against the standard of the ECHR and not against the standard of the national constitution *Grondwet*.

In Germany, the analysis of the applicability of fundamental rights to further unbundling measures as proposed by the Commission, or more specifically, any possible implementation of such measures into German law, leads to the conclusion that ownership unbundling would be a disproportionate expropriation and

"deep" independent system operation would be a regulation of ownership amounting to expropriation, which would also be disproportionate.

In the UK, the complete transfer of the investment decision and commissioning powers of the two vertically integrated electricity transmission network owners in Scotland would mean a deprivation of property in the form of a *de facto* expropriation while complete ownership unbundling would be a deprivation of property in the form of an expropriation according to the ECHR as applied in the UK via the Human Rights Act 1998.

In the Netherlands, the vertical integrated energy supply undertakings wholly owned by municipalities and provinces in principle enjoy fundamental rights protection under the ECHR whereas the public shareholders do not. It is, however, shown that any recourses to such protection would be of no avail. This is because under the ECHR, the deprivation of property in the form of (*de facto*) expropriation of the vertically integrated energy distribution networks would be unlikely to be classified as disproportionate as long as sufficient compensation is paid, which however would be of no use to the vertically integrated energy supply undertakings owned by subdivisions of the Dutch State given that such compensation would just circulate within the (Unitary) state organization.

Measuring the two original Commission proposals against the fundamental rights protection as afforded by the ECJ, ownership unbundling is classified as a deprivation of property in the form of an expropriation and "deep" independent system operation a deprivation of property in the form of a *de facto* expropriation, both of which would be disproportionate.

Further, the acceptance in the Commission proposals and in the current draft Directives that the mere transfer of publicly owned energy transmission networks to a part of the state organization separate from the part, which is responsible for the publicly owned vertically integrated energy supply undertaking would fulfil the unbundling requirements of the new legislation amounts to a manifest breach of the principle of equality because it would significantly disadvantage private undertakings.

As regards the question of whether public owners and shareholders and vertically integrated energy supply undertakings (partly) owned or controlled by public institutions such as municipalities and provinces can claim fundamental protection, one has to distinguish between the situation in Germany, that under the ECHR and that under EC law.

In Germany, it is argued here that both municipalities, which possess a special status within the federal state organization because their institutional existence is constitutionally guaranteed, and the vertically integrated energy supply undertakings (partly) owned by them (in public and public private undertakings of public and private law) would enjoy protection of their (economic) fundamental rights under the German Constitution in the specific context of pursuing a competitive economic activity of energy supply.

Under the ECHR, it is established that municipalities as governmental organizations according to Article 34 ECHR are not protected. It is, however, further argued here that vertically integrated energy supply undertakings would be protected if they possess legal personality (no matter whether under public or private law) as long as their legal personality is recognized under national law and as long as they do not exercise public authority; both characteristics distinguish them from belonging to the state organization.

In the EU, fundamental rights protection solely depends on whether undertakings seeking such protection pursue an economic activity and take part in the competitive process, no matter whether it possesses legal personality. Thus, public and private undertakings are likely to enjoy protection.

When it comes to effective fundamental rights protection, it seems that the German BVerfG offers the higher standard compared to the ECtHR and in particular the ECJ.

The proportionality test as applied by the BVerfG in Germany, has been developed into a very detailed and elaborate process of balancing the various opposing interests at stake in the case of interference with fundamental rights and has been strictly and effectively applied in Germany also in the context of reviewing parliamentary legislation.

The fair balance test used by ECtHR by contrast albeit similar in structure to the proportionality test rarely considers fundamental rights interferences disproportionate, which as has been explained before seems to be attributable to two reasons: first, to date the provision of adequate compensation appears to have had a significant influence on the proportionality of state measures under review and, secondly, the Court accepts that the Member States and local authorities are usually better equipped to judge the proportionality of fundamental rights interferences of measures they enforce.

Although EC (case) law includes a proportionality test similar in structure to the test applied in Germany, on the basis of the case law under review here of, the three courts the ECJ seems to afford the least effective fundamental rights protection because it hardly ever finds fundamental rights interference disproportionate, particularly so in the area of economic fundamental rights such as the right to property.

D. Selection of conclusions and outlook

Economic (and technical) evidence shows that more effort should be put into promoting generation, which if done properly would even make the extension of energy transmission network interconnection less urgent, which in turn would weaken one of the main arguments put forth in favour of further unbundling.

When one looks into what further unbundling does for the European energy supply markets, energy transmission network ownership unbundling delivers only marginal benefits for the creation of an internal and competitive energy supply market and the consumers' benefit. In addition, its benefits for increased investment are, to say the least, unclear. Security of energy supply is better served by other policies, namely by installing more (independent) generation capacity, which also has a greater impact on the development of competition than further network unbundling. What is more, further energy transmission network unbundling would, contrary to its purpose, unlevel the playing field in the European energy supply markets even further.

Further unbundling measures as envisaged by the original Commission proposals and even more by the current draft Directives, i.e. inclusive of the ITO model, is likely to intensify vertical integration of energy production and retail. The third energy package deepens regulatory differences in the Member States; differences in energy supply market structure in the various Member States might become even greater. Further network unbundling of public and private vertically integrated energy supply undertakings carries the same label ("ownership unbundling"), but could effectively mean less intrusive unbundling for public undertakings thus leading to unequal treatment of the public and private energy supply companies (and thus unequal interference with their respective economic fundamental rights), which would also affect their investment opportunities in Member States which have enforced ownership unbundling.

It is, however, shown that properly regulated TPA implemented via competition law enforcement, which may also include the connection of generation, is one of a combination of measures, which can achieve the goal of a more competitively working internal energy supply market in a proportionate way.

One of such measure is the release of gas and/or electricity generation considering that liquid energy wholesale markets or independent generation and independent import contracts (hub trading) with gas producers combined with access to gas import pipelines (pipeline capacity trade independent of gas take obligations) are actually more effective and efficient than energy transmission network ownership unbundling to achieve an internal and competitive energy supply market and also considering that the European Union does not have the competence to regulate in this area as it falls into the remit of the Member States' to regulate their national energy production sectors.

Another such measure is the tightening of the regulatory regime already in place in order to clarify ambiguities and to narrow down margins of interpretation. Uniform requirements for the extension of electricity and gas transmission interconnectors in all Member States and the promotion of merchant transmission, including by way of predictable and uniform licence conditions to enhance the availability of energy throughout the European Union, is another prerequisite for the development of energy supply competition in the EU. Further, stronger regional cooperation is required as envisaged by the current draft Directives including the strengthening of ERGEG.

The imposition of further unbundling measures on the European energy supply industry with such far-reaching consequences for the (economic) fundamental rights of the intended targets of such measures cannot be done by simply disregarding the common constitutional traditions of the Member States or merely assuming the application of the "lowest common denominator" of fundamental rights protection.

The ECJ should *effectively* develop and enforce a fundamental rights standard in the European Union, which is based on the common constitutional traditions of the Member States. As the "constitutional" court of the European Union with corresponding judicial powers, which are supposed to ensure the compliance of EU institutions with EC law including EC fundamental rights, its role is more akin to that of national courts than to that of the ECtHR.

Effective fundamental rights protection by the ECJ would in turn enhance the national acceptance of the *supra*-national legal order, which would in turn enhance the democratic functioning of the EU, and would encourage greater cooperation at EU level with respect to the completion of the internal market. It would further secure the rule of law at EC level by restraining political bargaining, which is sometimes far removed from its democratic foundations. It would also make the Commission and the Parliament aware of their role in not only guarding

the Treaty's objective to of constructing the internal market but also the Treaty's other objective, which is to respect common constitutional traditions.

Similar to the significant influence which the UK approach to energy supply sector regulation has had on EC energy supply sector regulation, the German approach to a structured (economic) fundamental rights protection should significantly assist the EU in making its approach to fundamental rights protection more robust and effective.

OVERVIEW

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

ACER	Agency for the cooperation of energy regulators
BayVGHE	Official publication of Constitutional Court of (German State of) Bavaria decisions (cited as BayVGHE volume, page)
BETTA	British Electricity and Transmission Arrangements
BG	British Gas plc.
BGBl.	Bundesgesetzblatt (German Gazette; official publication of legislation)
BGH	Bundesgerichtshof (highest German court in civil and criminal matters)
BGHZ	Official publication of Bundesgerichtshof (in civil matters) decisions (cited as BGHZ volume, page)
BKartA	Bundeskartellamt (German competition authority)
BNetzA	Bundesnetzagentur (German regulator of network-bound electricity, gas, telecommunications, postal and rail sectors)
BSC	Balancing and Settlement Code
BT-Drs.	Bundestag-Drucksache (German Federal Parliament printed matter; cited as BT-Drs. parliamentary term/consecutive number; e.g., BT-Drs. 2/3440)
BTO Elt	Bundestarifordnung Elektrizität (Federal Tariff Ordinance on household electricity price increases)
BVerfG	Bundesverfassungsgericht (German Federal Constitutional Court)
BVerfGE	Official publication of Bundesverfassungsgericht decisions (cited as BVerfGE volume, page)
BVerwG	Bundesverwaltungsgericht (highest German court in public law matters)
BVerwGE	Official publication of Bundesverwaltungsricht decisions (cited as BVerwGE volume, page)
CAT	Competition Appeals Tribunal
CC	Competition Commission (previously Monopolies and Mergers Commission)

CEGB	Central Electricity Generating Board
CFI	European Court of First Instance
ch.	Chapter
CHP	Combined heat and power generation
CUSC	Connection and Use of System Code
DG	Distributed generation
DGFT	Director General of Fair Trading
Draft Energy Directives	Draft Electricity and Gas Directives (as passed by the European Parliament in April 2009 and finally adopted unamended by the Council of the European Union on 25 June 2009)
DSO / DNO	Distribution System / Network Operator
DTe	Dutch energy regulator Directie Toezicht Energie
DTI	Department of Trade and Industry
EC	(Treaty establishing the) European Community
ECA	European Communities Act 1972
ECFR	Charter of Fundamental Rights of the European Union
ECHR	European Convention of Human Rights
ECJ	European Court of Justice
ECtHR	European Court of Human Rights
Energy Directives	Electricity and Gas Directives
Energy Regulations	Electricity and Gas Regulations
EnWG	Energiewirtschaftsgesetz (German Energy Industry Act)
ERGEG	European Regulators' Group for Electricity and Gas
ESU	Energy supply undertaking
EU	(Treaty on) European Union
E-wet	Dutch Electricity Act 1998
GB	Great Britain (England, Wales and Scotland)
GC	Grid Code
GEMA	Gas and Electricity Markets Authority
GG	Grundgesetz (German Constitution)
GTS	Gas Transport Services B.V.
G-wet	Dutch Gas Act
GWB	Gesetz gegen Wettbewerbsbeschränkungen (German Competition Act)
HRA	Human Rights Act 1998
IGT	Independent Gas Transporter
I&I-wet	Interventie&Implementatiewet

ITO	Independent Transmission Operator
ISO	Independent System Operator
Kamerstuk	Document exchanged between Dutch government and Dutch Parliament
LDZ	Local Distribution Zone
LTC	Long-term contract
Merger Regulation	Regulation (EC) No. 139/2004
Modernization Regulation	Regulation (EC) No. 1/2003
NCA	National Competition Authority
NETA	New Electricity Trading Arrangements
NEV Gas	Netzentgeltverordnung Gas (Regulation on gas network charges)
NEV Strom	Netzentgeltverordnung Strom (Regulation on electricity network charges)
NGC	National Grid Company plc.
NGET	National Grid Electricity Transmission plc.
NGG	National Grid Gas plc.
NMa	Nederlandse Mededingingsautoriteit (Dutch competition authority)
NRA	National Regulatory Agency
NTS	National Transmission System
NZV Gas	Netzzugangsverordnung Gas (Regulation on gas network access)
NZV Strom	Netzzugangsverordnung Strom (Regulation on electricity network access)
OFGEM	Office for Gas and Electricity Markets
OFT	Office of Fair Trading
PES	Public Electricity Company
Proposed Energy Directives	Proposals of September 2007 by the European Commission for Electricity and Gas Directives (also cited as (2007) Commission Proposals)
REC	Regional Electricity Company
RES	Renewable energy sources
RIA	Regulatory Impact Assessment
SCBA	Social cost and benefit analysis
Sep	Samenwerkende electricteits-productiebedrijven
SO/TO Code	System Operator/Transmission Owner Code
SP	Scottish Power
SSE	Scottish and Southern Energy
Stb.	Staatsblad van het Koninkrijk der Nederlanden (official publication of legislation)

Stc.	Staatscourant van het Koninkrijk der Nederlanden (official publication of statutory instruments)
TFEU	Treaty on the Functioning of the European Union (Lisbon Treaty)
TPA	Third Party Access
TSO	Transmission System Operator

INTRODUCTION
SETTING THE SCENE

In March 2000, the so-called Lisbon Agenda solemnly declared as a new strategic goal of the European Union for the next decade "to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion."[1] In order to achieve this goal, the European Council announced an overall strategy, part of which is "stepping up the process of structural reform for competitiveness and innovation and […] completing the internal market". This would require economic reforms in order to reap the benefits of market liberalization. The European Council considers it essential to apply fair and uniform competition so that businesses can thrive and operate effectively on a level playing field in the internal market.[2] The European Council accordingly asked the Commission, the Council and the Member States, "each in accordance with their respective powers", *inter alia* "to speed up liberalisation in areas such as gas, electricity, postal services and transport [with the] aim […] to achieve a fully operational internal market in these areas."

When presenting the preliminary findings of the Energy Sector Inquiry, which is based on data material of 2005[3], Neelie Kroes, the incumbent European Commissioner in charge of competition policy, emphasized on 16 February 2006 that the European electricity and gas markets showed a high degree of market concentration.[4] Related thereto, new entrants were prevented from entering these markets by way of vertical foreclosure. She complained of a lack of market integration in Europe and a lack of market transparency and concluded that a well-functioning and transparent market mechanism for setting prices was largely absent. Commissioner Kroes concerns about the structure of the market

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1 Presidency Conclusions, Lisbon European Council, 23 and 24 March 2000.

2 One major aim with respect to the creation of a so-called level playing field is the prevention of cross-subsidization or cross-subsidies; in greater detail, see B Willems, E Ehlers, 'Cross-subsidies in the Electricity Sector', (2008) CRNI 101.

3 In greater detail, see Communication from the Commission, 'Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report)', COM(2006) 851 final, Brussels, 10.1.2007.

4 N Kroes, 'Towards an Efficient and Integrated European Energy Market – First Findings and Next Steps', European Commission Conference, Energy Sector Inquiry – Public Presentation of the Preliminary Findings, Brussels, 16 February 2006.

centred on the "bundling of generation, supply, pipelines and grids, and distribution." She therefore welcomed the move "towards full structural unbundling", which would "allow a more efficient market to develop" claiming that "[r]egulation would be made less complex and more effective." Referring to her remit in this context, she then went on to say that competition enforcement "dances not alone, but in step with regulation." "Regulation opens the market – and competition policy makes sure that the opened markets really work." "And when it comes to redefining the dancefloor – […] fundamental restructuring of the energy marketplace – both dancers need to step into motion. Andris Piebalgs [the European Commissioner responsible *inter alia* for the regulation of the energy markets] and I myself are fully committed to just that."[5]

In its Communication of 10 January 2007 setting out "[a]n Energy Policy for Europe"[6], the European Commission states that Europe needs "to deliver *sustainable*, *secure* and *competitive* energy."[7]

The Commission continues: "A real Internal Energy Market is essential to meet all three of Europe's energy challenges:

- Competitiveness: a competitive market will cut costs […] and stimulate energy efficiency and investment.
- Sustainability: […] transmission system operators must have an interest in promoting connection by renewable, combined heat and power and micro generation, stimulating innovation and encouraging […] non-conventional supply.[8]
- Security of supply: an effectively functioning and competitive Internal Energy Market can provide major advantages in terms of security of supply and high standards of public service. The effective separation of networks from the competitive parts of the electricity and gas business results in *real* incentives for companies to invest in new *infra*structure, inter-connection capacity and new generation capacity, thereby avoiding black-outs and unnecessary price surges."[9]

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5 Comment added.

6 Communication from the Commission, 'An Energy Policy for Europe', COM(2007) 1 final, Brussels, 10.1.2007.

7 Emphasis added. For a review of this *trias* of challenges, see E Ehlers, 'The Amsterdam and Berlin Fora and the Forum Process in European Energy Policy', in M Roggenkamp, U Hammer (eds), *European Energy Law Report IV*, 2007, chapter 6.

8 Evaluating the interest to connect distributed generation (i.e. electricity generation connected to the distribution networks) from an interdisciplinary legal and economic perspective, see G Brunekreeft and E Ehlers, 'Ownership Unbundling of Electricity Networks and Distributed Generation', (2006) CRNI 63.

9 Emphasis added. For a very recent economic social cost and benefit analysis of ownership unbundling in the electricity supply sector, which also evaluates the "real" incentives to

As these objectives have not yet been achieved according to the Commission[10], it has identified *inter alia* the following measures for implementation:

- "a full Independent System Operator (where the vertically integrated company remains owner of the network assets and receives a regulated return on them, but is not responsible for their operation, maintenance or development) or
- ownership unbundling (where network companies are wholly separate from the supply and generation companies)."[11]

The Commission claims that "[e]conomic *evidence* shows that ownership unbundling is the most effective means to ensure choice for energy users and to encourage investment."[12] Further, correlating to the new unbundling measures mentioned before, the Commission endeavours to make regulation more effective

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invest in new *infra*structure, see G Brunekreeft, 'Ownership Unbundling in electricity markets – a social cost benefit analysis of the German TSO's', EPRG Discussion Paper 08–16, 2008, and UNECOM Discussion Paper DP 2008–05, 2008. See also G Brunekreeft, 'Eigentumsentflechtung, Deep-ISO, der Dritte Weg – wohin führt die Reise der europäischen Energiemärkte', (2008) ZfE 177.

10 See Communication of the Commission, 'Prospects for the internal gas and electricity market', COM(2006) 841, Brussels, 10.1.2007, and the Sector Inquiry, n. 3. Perceived as one of the main obstacles is the "systemic conflict of interest inherent in the vertical integration of supply and network activities" (see the Sector Inquiry, n. 3, nos 52–3), namely the preference of group or related companies, see further n. 53, on the one hand and the lack of willingness to invest for fear of increased competition on the other.

11 In order to ensure that the incentives for the owner and/or operator of the energy networks are not distorted by the interests of connected supply undertakings, the Commission deems it "necessary to decisively reinforce the current inadequate level of unbundling [of the energy networks]." See the Sector Inquiry, n. 3, no. 54. The Commission claims that owernship unbundling already exists for electricity in Denmark, Finland, Italy, the Netherlands, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom, and for gas in Denmark, the Netherlands, Portugal, Romania, Spain, Sweden and the United Kingdom; in all cases, the unbundled transmission system operators (TSO) are also the owners of the energy networks they operate. See, however, J-C Pielow, 'Unbundling I: EU-Rechtsvergleich', in Löwer (ed.), *Neue rechtliche Herausforderungen für den Strommarkt*, Bonner Gespräch zum Energierecht, 2008, and 'Erfolgsstory "Ownership Unbundling"? Anmerkungen aus rechtsvergleichender Sicht', (2008) RdE 345, showing that this is a rather simplistic view and in places even inaccurate. In this respect see also *infra* chapters 5 and 6 on the United Kingdom and the Netherlands.

12 See the Sector Inquiry, n. 3, no. 55. Emphasis added. Until today, the Commission has however hardly tabled any evidence in this respect. Some indications can be found in P Lowe, I Pucinskaite, W Webster, P Lindberg, 'Effective unbundling of energy transmission networks: lessons from the Energy Sector Inquiry', (2007) 1 Competition Policy Newsletter 23; all the authors work for the European Commission. But see NERA Economic Consultants, 'Structure and Performance in Europe: A Review of the Report for DG COMP', Energy Regulation Insights, Issue 33, April 2007, reviewing a report of London Economics (commissioned by the European Commission) on the 'Structure and Performance of Six European Wholesale Electricity Markets in 2003, 2004 and 2005' (February 2007). London Economics alleges that the European electricity market works insufficiently. Also critical A Ockenfels, 'Marktmachtmessung im deutschen Strommarkt in Theorie und Praxis – Kritische

by claiming that "[t]here is a relation between unbundling and regulation. Markets in which there is less than ownership unbundling require more detailed, complex and prescriptive regulation. In such circumstances national Regulators need in particular more intrusive and burdensome powers to prevent discrimination. However, disincentives to adequately invest in networks without ownership unbundling cannot in any event be fully addressed by Regulators."[13]

A. MOTIVATION OF RESEARCH

The unbundling measures mentioned above and in particular the full structural separation or unbundling of the energy transportation networks from electricity generation and energy supply shall be the topic of this work. The research offered here is motivated by recent draft legislation as well as by Commissioner Kroes' threat to break up so-called vertically integrated energy supply undertakings, which contain both energy transportation *infra*structure and energy supply businesses. All of this will be judged in the light of economic theory and empirical evidence, the latter of which is only just beginning to emerge.

I. LEGISLATIVE PROPOSALS AND CONTINUING TOPICALITY

On 19 September 2007, the Commission tabled two proposals for Electricity and Gas Directives prescribing further unbundling measures for the electricity and gas supply sectors of the EC[14] Member States, which evolved from the above mentioned announcements; they are part of a draft package of five pieces of third generation energy supply sector legislation for the promotion of further liberalization of the European energy markets, which envisages the restructuring of the energy supply industry as well as the tightening of regulatory oversight

Anmerkungen zur London Economics-Studie', (2007) 9 et 12. See further Brunekreeft, EPRG, n. 9, pp. 8–9.

13 See n. 12. In this respect, the Commission has also not tabled any evidence. The doubtfulness of this argument is elaborated upon *infra*, Part 1 Chapter 2.

14 The draft legislation at issue here is based on the Treaty establishing the European Community (consolidated version), OJ 2006 C 321 E/37, 29.12.2006. The measures envisaged are to be enforced throughout the European Union. In the context of analyzing fundamental rights issues, reference is made to the Treaty on European Union (consolidated version), OJ 2006 C 321 E/5, 29.12.2006. Apart from referring to specific EC legislation, or to provisions of the EC or EU Treaties, EC and EU are used interchangeably. Any Protocols referred to in this work are to be found in OJ 2006 C 321 E/187, 29.12.2006.

under the lead of the European Commission.[15] These proposals are supposed to adjust current legislation, in particular the internal electricity and gas market Directives 2003/54/EC and 2003/55/EC (thereafter "2003 Energy Directives", "2003 Electricity Directive" or "2003 Gas Directive"), which explicitly exclude an obligation of ownership unbundling.[16]

Under the groundbreaking heading "Energising Europe: A *real* market with secure supply"[17], complete ownership unbundling of the electricity and gas networks is favoured so that "no supply or production company active anywhere in the EU can own or operate a transmission system in *any* Member State of the EU" (and *vice versa*).[18] Consequently, ownership of transmission assets would have to be transferred to completely independent third parties, which would also exclusively operate these networks. In other words, this is about the separation of all network functions from the other activities of the energy supply undertakings (ESU); any influence whatsoever of the previously vertically integrated ESUs on the operation of the networks would be prohibited; supply and generation companies would no longer be allowed to exercise any direct or indirect control over the independent network operators (and *vice versa*).[19] Consequently,

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15 See Commission of the European Communities, *Proposals* for a Directive amending Directive 2003/54/EC concerning common rules for the internal market in electricity, COM(2007) 528 final, 2007/0195 (COD), for a Directive amending Directive 2003/55/EC concerning common rules for the internal market in natural gas, COM(2007) 529 final, 2007/0196 (COD), for a Regulation establishing an Agency for the Cooperation of Energy Regulators, COM(2007) 530 final, 2007/0197 (COD), for a Regulation amending Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity, COM(2007) 531 final, 2007/0198 (COD), and for a Regulation amending Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks, COM(2007) 532 final, 2007/0199 (COD), Brussels, 19 September 2007; all proposals are introduced by the same *Explanatory Memorandum*. See further Commission of the European Communities, *Impact Assessment* accompanying the legislative package on the internal market for electricity and gas, COM(2007) 528 final, COM(2007) 529 final, COM(2007) 530 final, COM(2007) 531 final, COM(2007) 532 final, Commission Staff Working Paper (SEC(2007) 1179), Brussels, 19 September 2007, in the following also referred to as "RIA".

16 See Article 15(1) 2nd sentence Directive 2003/54/EC of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ 2003 L 176/37, 15.7.2003 ("2003 Electricity Directive"), and Article 13(2) 1st sentence Directive 2003/55/EC of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ 2003 L 176/57, 15.7.2003 ("2003 Gas Directive").

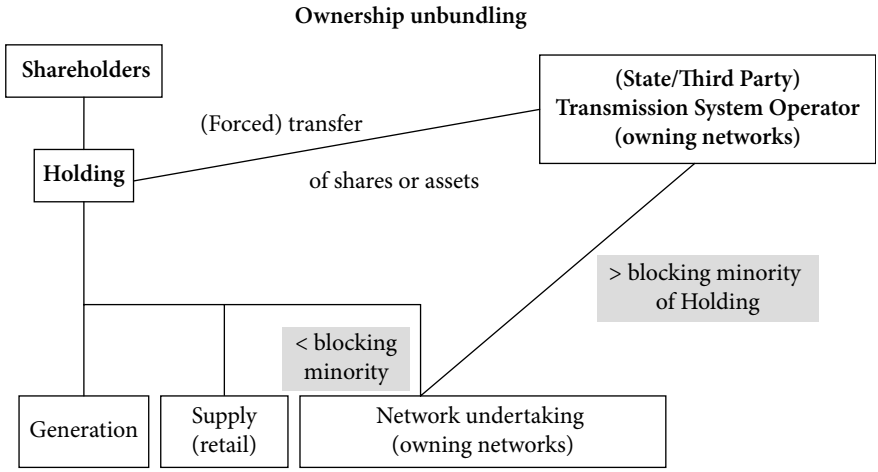
17 See IP/07/1361 (19.9.2007); emphasis added.

18 *Explanatory Memorandum*, n. 15, p. 7. Emphasis added. This is to replace the legal, operational and accounts unbundling already in place, see Article 10, 12, 15 *et seq.*, 18 *et seq.* Electricity Directive 2003, Article 9 *et seq.*, 13 *et seq.*, 15, 16 *et seq.* Gas Directive 2003.

19 The same person(s) would not be allowed to exercise, *solely* or *jointly*, any control over any supply undertaking and hold (controlling or blocking minority) interests in or exercise (controlling or blocking minority) rights over any transmission system operator or any transmission system and *vice versa*, i.e. control over a transmission system operator

ownership unbundling à la Commission of the energy transportation function would look as illustrated in Figure 1.[20]

Figure 1. Ownership unbundling



As an alternative solution to the above, the Commission has proposed the Independent System Operator model, according to which "vertically integrated companies […] retain the ownership of their network assets, but [which] requires that the transmission network itself is managed by an independent system operator – an undertaking or entity entirely separate from the vertically integrated company – that performs *all* the functions of a network operator."[21]

precludes the possibility of holding (controlling or blocking minority) interests in or exercising (controlling or blocking minority) rights over an energy supply undertaking. Thus, any influence over the composition, voting or decisionmaking of the bodies of both transmission system operators and supply undertakings would be prohibited. The proposed Energy Directives refer to 'control' as used in Article 3(2) Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ 2004 L 24/1, 29.1.2004. See also, for an interpretation of 'control', Bechtold/Bosch/Brinker/Hirsbrunner, EG-Kartellrecht, Kommentar, 2005, Article 3 FKVO, nos 12 *et seq.*, and the recent 'Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings', OJ 2008 C 95/1. Article 8(1) of the proposed Electricity Directive and Article 7(1) of the proposed Gas Directive, n. 15, prohibit any holding of an interest in one activity when the other is controlled.

20 The Commission also considers the unbundling requirements of its proposals sufficiently observed if a Transmission System Operator (TSO), which is vertically integrated in an ESU in public ownership, is transferred to another publicly owned legal person. See *Explanatory Memorandum*, n. 15, p. 6. See in greater detail *infra*, Part 2 Chapter 7 on the European Union.

21 *Explanatory Memorandum*, n. 15, p. 5. Emphasis added.

Here as well, however, energy supply and production companies would not be allowed to own shareholdings which enable them to exercise control over the Independent System Operator (ISO).[22] The different types of ISO are illustrated in Figure 2.

Even the alternative solution of introducing ISOs would require that vertically integrated transmission network owners in the Member State where the ISO model has been introduced are not only *not* allowed to operate transmission networks *anywhere else* in the EU, but as they pursue production or supply activities, they would equally not be allowed to own and pursue such activities in Member States where ownership unbundling has been enforced instead of ISOs.[23] Similarly to the favoured option of ownership unbundling, this means that existing network activities would have to be sold or vice versa.[24]

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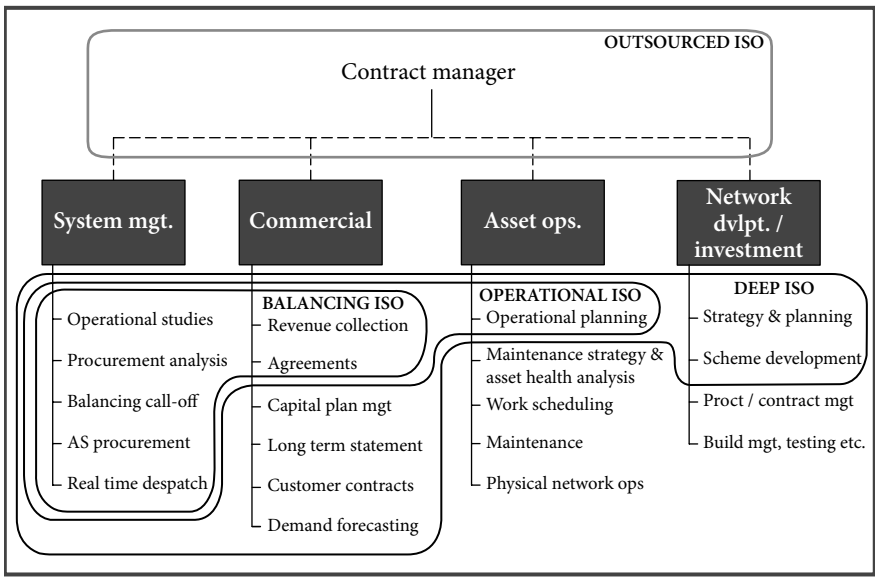
22 The proposals prohibit persons controlling energy supply activities (incl. network property), to be at the same time invested in a transmission system operator, see Article 10(2)(a) of the proposed Electricity Directive and Article 9(2)(a) of the proposed Gas Directive, n. 15. On the other hand, it seems that minority shareholdings in both activities are admissible as long as they are not controlling and not capable of blocking decisions, see p. 6 of the proposals' *Explanatory Memorandum*, n. 15. The network operators would be the primary interface to network users. They would be solely responsible for the network operation and electricity generation dispatch in the electricity networks, and for developing the network they operate, i.e. for planning (including any authoritsation procedures), construction and commissioning of *infra*structure (i.e. either from the network owner or presumably by way of tender from third parties). The latter would include maintenance and extension of the energy networks they operate and new network investment. see Article 10(5) of the proposed Electricity Directive and Article 9(5) of the proposed Gas Directive, n. 15. ISOs with such far reaching powers are also commonly called "deep" ISOs, see in this respect also J-C Pielow, G Brunekreeft, E Ehlers, 'Legal and Economic Aspects of Ownership Unbundling in the EU', (2009) JWELB, published on 11 May 2009, also with further references.

23 Although Recitals 10 and 11 of the proposed Energy Directivea, n. 15, refer to system operators only, Articles. 8(1), 8(2), 10(2)(a) and 10a of the proposed Electricity Directive in conjunction with p. 7 (1st para.) of its *Explanatory Memorandum*, for instance, might be read in this way; at least the wording is ambiguous in this respect. This conclusion seems also to be supported by the proposed Energy Directives' referral to the EU wide applied term of control, see n. 19.

24 This would, for example, be the case for companies such as E.ON of Germany for its activities in the UK.

Figure 2. The different types of independent system operation classified according to the extent of powers operators possess



Source: Frontier Economics

Finally, the proposals explicitly provide for a so-called share split[25], which under certain circumstances can lead to full ownership unbundling by way of forced sale, and which the Commission has adopted with the aim of accommodating several Member States and in particular Germany.[26] This option stipulates that the current shareholders will receive for their share in the vertical integrated energy undertaking as it stands now (i.e. including the networks) two separate shares in a newly incorporated and completely independent network company, which also owns the networks, and in the remaining supply and/or production company. The share split as envisaged by the Commission would look as illustrated in Figure 3. The proposals prescribe in this context that if after the share split, one of the then two shareholdings were a controlling stake[27], this or the other shareholding would have to be sold within a certain period.[28]

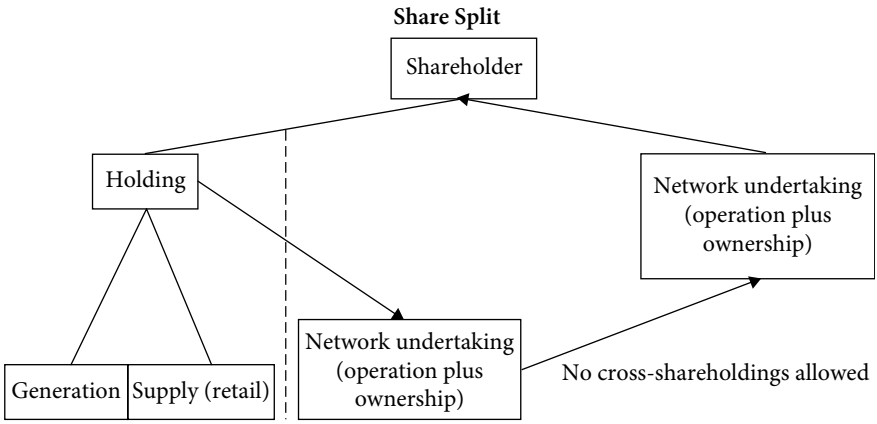
25 See *Explanatory Memorandum*, n. 15, p. 5, and Recital no. 11 of the proposed Directives. See also S Thomas, 'A critique of the European Commission's Impact Assessment on the legislative package for electricity and gas', PSIRU, University of Greenwich, London, November 2007, criticizing the share split as an ill-thought through option.

26 See W Möschel, 'Widerstand gegen EU-Vorschläge', F.A.Z., 10.01.07, and 'Die Entflechtung ist kein Allheilmittel', F.A.Z., 19.09.07.

27 As regards details on control, see n. 19.

28 Article 8(4) of the proposed Electricity Directive.

Figure 3. Share split



At the end of January 2008, a third option was tabled by a group of eight Member States led by France and Germany called the "Third Way" or "Effective and Efficient Unbundling"[29], which compared to the Commission's proposals is merely a stricter form of legal unbundling. It proposes the holding of the different energy supply activities, in particular energy transportation, in separate legal entities. The main feature of this option is the transfer of the vertically integrated network company into the legal form of a public limited company or similar, which owns the energy transmission networks, and which together with supplementary requirements is supposed to strengthen the independence of network operations from the remainder of the vertically integrated energy supply group of undertakings.[30]

On 10 October 2008, the Council of Energy Ministers agreed a compromise allowing for all three options to be offered to the Member States.[31] Consequently, since the "Third Way" (in the meantime renamed into Independent Transmission

29 See Euractiv, 'Eight EU states oppose unbundling, table 'third way'', 1 February 2008, which links to the original 'third way' proposal.

30 F Säcker, 'Das "institutionelle Design" des Independent System Operator', presentation at FGE Tagung 2007, Aachen, 20 September 2007, and 'The 'deep' independent system operator – A German perspective on implementing an effective and efficient unbundling of TSOs', (2008) 3 EREM 19.

31 See SPIEGEL, 'EU-Energieminister ordnen Gas- und Strommärkte neu', 10 October 2008. See also Euractiv, 'Paris and Berlin win EU energy liberalisation deal', 9 June 2008, 'Parliament insists on splitting energy giants', 19 June 2008, and 'Parliament backs 'third way' for gas market opening', 10 July 2008. On 23 March 2009, the European Parliament and the Czech EU Presidency reached an agreement on the third energy package, which apart from some changes in detail left all three unbundling options offered to the Member States on 10 October 2008 intact, see Euractiv, 'EU strikes deal on energy market liberalisation', 25 March 2009.

Operator (ITO)) simply tightens the legal unbundling requirements already in place, not much will change for the time being as it leaves it to the discretion of the Member States, which option to implement.[32] However, the compromise also contains a revision clause, according to which the success of this third generation package of energy legislation will be reviewed two years after its implementation.[33] This is what keeps this research highly topical in that the issue of ownership unbundling is likely to feature on the political agenda again soon; then, however, it would seem unlikely that a compromise solution such as the "Third Way" will be accepted again.

This compromise was approved by the European Parliament with some amendments in detail on 22 April 2009, see further nn. 33 and 95 *infra* and accompanying text.

32 The "Third Way" will not be discussed any further here; it will, however, play some role in Part 2 Chapter 4 on Germany. For an evaluation, see E Ehlers, 'EEU: Is the "Third Way" the Way Forward?', presentation at EURELECTRIC Discussion Workshop "The 3rd Energy Package: Alternative models for System Operation, Regional Integration and Unbundling", Brussels, 31 March 2008, and Brunekreeft, (2008) ZfE 177, n. 9. Also not discussed here is the "Scotland" clause of the draft Electricity and Gas Directives, n. 33 *infra*, which is *not* a fourth unbundling option but just the confirmation that the electricity sector unbundling in Scotland (rightly) fulfils the minimum requirements of the draft Directives. On Scotland, see in greater detail Part 2 Chapter 5 on Great Britain.

33 See Articles 47(3)-(5), 49(1) draft Electricity Directive, Articles 51(3)-(5), 53(1) draft Gas Directive; according to these drafts, the Member States have 18 months after their entry into force to implement them plus an additional two years until the Commission reviews the effectiveness of the "Third Way" or "Effective and Efficient Unbundling", or as it is now called, the "Independent Transmission Operator" (ITO). The complete drafts as approved by the European Parliament on 22 April 2009 (and finally adopted unamended by the Council of the European Union on 25 June 2009, see Council of the European Union, 'Council adopts internal energy market package', Press Release 11271/09 (Presse 191), Luxembourg, 25 June 2009) are available as follows: European Parliament legislative resolutions of 22 April 2009 on the Council common position for adopting (1) a directive of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (14539/2/2008 – C6-0024/2009 – 2007/0195(COD)), P6_TA-PROV(2009)0241 (ITRE no. A6-0216/2009), (2) a directive of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (14540/2/2008 – C6-0021/2009 – 2007/0196(COD)), P6_TA-PROV(2009)0244 (ITRE no. A6-0238/2009), (3) a regulation of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 (14546/2/2008 – C6-0022/2009 – 2007/0198(COD)), P6_TA-PROV(2009)0243 (ITRE no. A6-0213/2009), (4) a regulation of the European Parliament and of the Council on conditions for access to the natural gas transmission networks and repealing regulation (EC) No 1775/2005 (14548/2/2008 – C6-0023/2009 – 2007/0199(COD)), P6_TA-PROV(2009)0245 (ITRE no. A6-0237/2009), and (5) a regulation of the European Parliament and of the Council establishing an Agency for the Cooperation of Energy Regulators (14541/1/2008 – C6-0020/2009 – 2007/0197(COD)), P6_TA-PROV(2009)0242 (ITRE no. A6-0235/2009).

II. THREAT TO BREAK UP INDIVIDUAL VERTICALLY INTEGRATED ENERGY SUPPLY UNDERTAKINGS

Another, complementary, motivation of looking into further unbundling of the energy supply industry in the EU arises from Ms Kroes' comments cited above. These comments raise the question whether and to what extent there is any scope and need for ordering the structural remedy of "full structural unbundling", divestiture or, in more legal terms, legal ownership unbundling of energy transportation networks (gas pipelines and electricity grids) from vertically integrated energy undertakings as corrective competition law enforcement *ex post*, i.e. when such dominant undertakings abuse their position and, thus, Article 82 EC applies.

Both, the legal uncertainty produced by lengthy negotiation of further unbundling legislation and by the threat of the European Commission acting as executive competition law enforcer, has already led to a situation where large players such as the German E.ON and RWE have "voluntarily" committed to sell some of their energy transportation networks in Germany, electricity transmission and gas transportation, respectively[34], which follows the patterns of the experience made by British Gas in the mid 1990's, when it took the voluntary commercial decision to break up its vertical integration in the light of ever tightening regulation.

III. GROWING EVIDENCE IN ECONOMIC RESEARCH OF DOUBTFUL SOCIAL BENEFIT

Apart from extensive criticism, especially from German legal scholarship, of the Commission's legislative proposals[35], attempts to further unbundle the industry on EU and Member States level[36] albeit sensible according to economic

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34 This happened in the first half of 2008 in the context of the investigation by the Commission into anti-competitive practices of these companies. For more detail, see Part 1 Chapter 2, n. 252.

35 More recently, J-C Pielow, E Ehlers, 'Ownership unbundling and constitutional conflict; a typical German debate?', (2008) 3 EREM 55; T Mayen, 'Eigentumsrechtliche Entflechtung der Energieversorgungsnetze', (2008) RdE 33; S Storr, 'Die Vorschläge der EU-Kommission zur Verschärfung der Unbundling-Vorschriften im Energiesektor', (2007) EuZW 232; U Büdenbender, P Rosin, 'Pro und Contra Ownership Unbundling in der Energiewirtschaft', (2007) and 20. Some support for ownership unbundling can be found in S Haslinger, 'Grundrechtsverletzung durch ownership unbundling', (2007) WuW 343.

36 For instance in the Netherlands. In this regard the elaborations in Part 2 Chapter 6.

theory[37] also take place amidst growing empirical economic evidence that such endeavours are not *per se* economically beneficial. Economists have formulated considerable reservations against ownership unbundling[38]; they point out in particular that the expectations for more competition and more interconnector capacity as a consequence of ownership unbundling may be too high. Moreover, they also stress that the benefits will come at a cost; on balance, it is unclear whether it actually pays off.[39]

Thus, with empirical economic evidence gaining momentum and the economics of the energy supply sector being claimed as *the* basis for further unbundling, this discipline is of pre-eminent interest to this work.

B. STRUCTURE OF NETWORK-BOUND ENERGY SUPPLY

The term "vertical integration" has already been used. In the context of energy supply, this relates to the various activities within the so-called energy supply

37 See, for example, M Pollitt, 'Ownership Unbundling of Energy Networks', Forum: Vertical Unbundling in the EU Electricity Sector, (2007) Intereconomics 292, and 'The arguments for and against ownership unbundling of energy transmission networks', CWPE 0737 and EPRG 0714, August 2007, both with further references. Ambiguously in this respect, M Mulder, V Shestalova, M Lijesen, 'Vertical separation of the energy distribution industry – An assessment of several options for unbundling', CPB Document No. 84, 2005.

38 See, for instance, J Haucap, 'The Costs and Benefits of Ownership Unbundling', Forum: Vertical Unbundling in the EU Electricity Sector, (2007) Intereconomics 301. See also G Brunekreeft, E Ehlers, 'Does Ownership Unbundling of the Distribution Networks Distort the Development of Distributed Generation?', TILEC Report, December 2005, and Brunekreeft/Ehlers, n. 8; B Baarsma, M de Nooij, 'An *ex ante* welfare analysis of the unbundling of the distribution and supply companies in the Dutch electricity sector', Discussion Paper no. 52, SEO, April 2007 (also available as UNECOM Discussion Paper DP 2008–02). See also G Brunekreeft, E van Damme, 'De Splitsing van de Energiebedrijven', TILEC Report, May 2005. For further guidance on the interference of ownership unbundling with the current technical structure of the sector, see M Finger, R Künneke, 'The need for coherence between institutions and technology in liberalized *infra*structures: the case of network unbundling in electricity and railways', MIR-Report-2006–009, College of Management of Technology, Lausanne, October 2006. Very critical as regards the situation in the English gas market and rebutting the Commission's idealistic view of the English ownership unbundled energy market model, SERIS, 'The advantages of full ownership unbundling in gas transportation and supply: how the European Commission got it wrong about the UK', Sheffield, June 2006.

39 *Cf.*, for instance, Brunekreeft, EPRG/UNECOM, n. 9. The consequence of ownership unbundling may even lead to less coordination of investment, i.e. wrong place, too late, too early, too much. There is also reason to believe that the network will become oversized. See in greater detail, Part 1 Chapter 2.

chain. In a simplified and schematic manner, energy (electricity and gas) supply is structured vertically as follows (see also Figure 4 below)[40]:

- Gas supply (chain): The upstream or wholesale market consists of gas production and/or import (by way of pipelines or liquefied natural gas (LNG)).[41] This gas is fed into physical (long distance transmission into shorter distance distribution) gas pipelines (also by way of LNG terminals where the liquefied gas is converted into gasified gas) or storages (for supply at a later time).[42] Thereafter, the gas so transported is fed out of the pipelines/storages on the downstream market consisting of supply/retail to customers (to include end-consumers).[43]
- Electricity supply (chain): The upstream or wholesale market consists of electricity generation (from a wide range of primary resources such as gas, nuclear, oil, coal, and renewable sources such as hydro and wind). The electricity is fed into physical (long distance transmission into shorter distance distribution) electricity grids. The electricity so transported is fed out of the (transmission or distribution) grids on to the downstream market consisting of supply/retail to customers (to include end-consumers).

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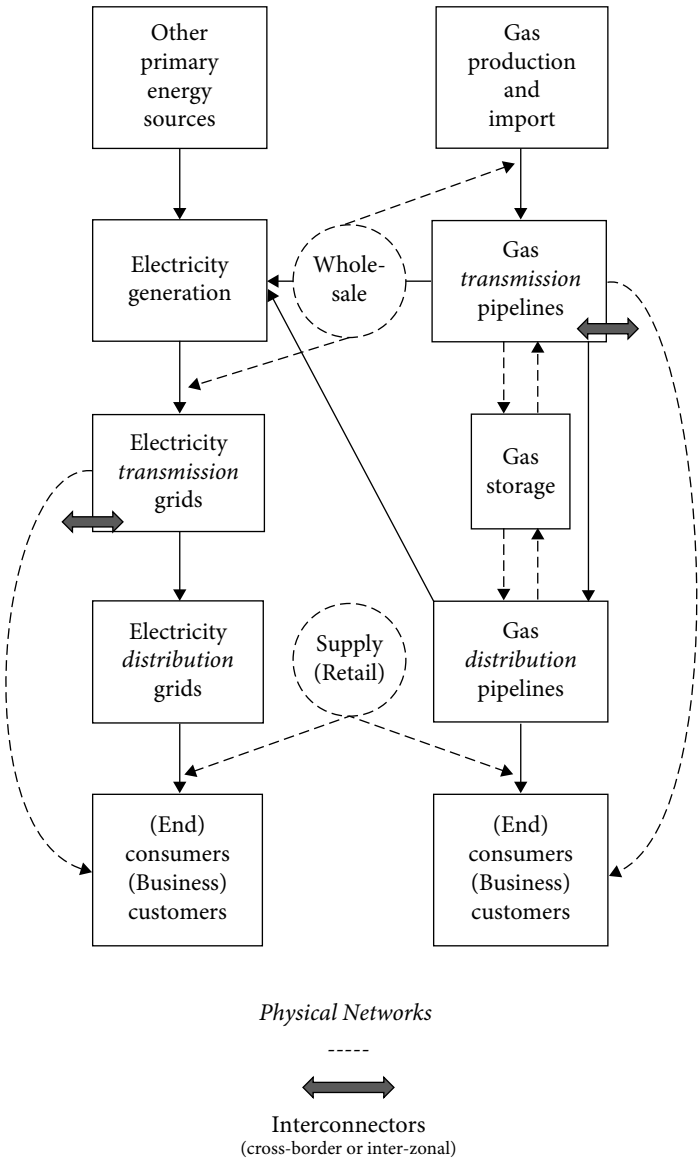
40 From the position of a market, which is part of a supply chain (consisting of at least three different markets), an upstream market is the direct or indirect input into such market (to which the upstream market such as electricity generation thus needs (connection and) access), whereas a downstream market is the market, for which such market is the direct or indirect input, see Willems/Ehlers, n. 2.

41 Although this area of gas supply is not the subject of this work, long-term supply contracts in this area are considered harmful to competition on the one hand, but also conducive to supply security on the other. See Part 1 Chapter 2, n. 223. According to the European Commission, 'Sector Inquiry under Art 17 Regulation 1/2003 on the gas and electricity markets', Preliminary Report, Brussels, 16 February 2006, p. 3, the lack of liquidity as result of long-term contracts between gas producers and incumbent importers makes it difficult for competitiors to access gas upstream.

42 Gas can also be stored by way of so-called line-pack, i.e. within (unused) pipelines, which is normally short-term.

43 Long-term supply contracts in this area do play a role in this work when it comes to the evaluation of anticompetitive behaviour by vertically integrated ESUs; they do, however, not feature prominently in this work. For a solution to this problem, see, for instance, the decision of the German competition authority *Bundeskartellamt* (BKartA), 13 January 2006, B 8 – 113/03 – 1, 'E.ON Ruhrgas i. S. "Langfristige Gaslieferverträge"'. See in greater detail n. 752 and accompanying text. See also the brief explanations by M van der Woude, 'Recent Developments in EU Competition Law: Busy Times', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports IV*, 2007, chapter 1, p. 11.

Figure 4. Energy supply chain



An important feature of electricity is its non-storability[44] and the fact that, contrary to gas, it cannot be steered along a certain path or grid line of the

[44] Unless, for instance used to fill water reservoirs, which when releasing water produce electricity. This has, for instance, been one of the motives for building the NorNed electricity

electricity grid.[45] Gas, to the contrary, is a primary energy source (as opposed to electricity, as secondary source) and can be stored unlike electricity. The gas market depends on large-scale investments in *infra*structure (as does the electricity market) and long-term (upstream) gas supply contracts from a handful of suppliers mostly outside the European Union, such as Russia and Norway (which belongs to the European Economic Area).

Interconnectors are highly relevant in national markets, which are divided into more than one energy transmission network area, as is the case in Germany and, more importantly, are necessary to achieve an internal market in energy supply within the EU; they function as joints between different gas and electricity systems: they connect import or upstream pipelines/grids to national transmission pipeline/grid networks[46], transmission pipeline/grid networks of different EU Member States, and, as for instance in Germany, different transmission pipeline/grid networks within the same Member State, and transmission pipelines/grids to distribution pipelines/grids within one Member State.[47]

C. ENERGY NETWORK UNBUNDLING: STAGES AND DEFINITIONS

In the current discussion about EU energy market liberalization, the term unbundling is often used to describe *the* way forward in the creation of an

transmission cable interconnecting the Netherlands and Norway, which imports Norwegian electricity at daytime only to export night excess electricity from the Netherlands to Norway, which uses this electricity to fill its water reservoirs. On the NorNed cable, C van der Lippe, P Meijer, 'A Regulator's View on the NorNed Cable – A Missing Link?', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports IV*, 2007, chapter 14.

45 Electricity network operators have to constantly keep the frequency of electricity in the electricity network system in balance, i.e. electricity supply (by way of generation) and demand, which includes network losses arising from transmission of electricity over longer distances. Similarly, gas network operators also have to balance the system in order to maintain adequate pressure in the pipelines to move the gas.Electricity and gas network operators thus must to some (limited) extent participate in electricity and gas trading, respectively.

46 The physical *infra*structure of the electricity grids and gas pipelines, which as has just been said, transport electricity or gas supplied from generation plants or production sites to customers, are connected within networks.

47 See K Talus, T Wälde, 'Electricity Interconnectors: A Serious Challenge for EC Competition Law', (2006) Competition and Regulation in Netowrk Industries (CRNI) 355, on cross-border interconnection being a separate product market, which can either serve as a substitute or alternative for electricity generation or as interconnection of two national electricity transmission grids. See also D Balmert, G Brunekreeft and J Gabriel, 'Independent System Operators – die Investitionsfrage', UNECOM Discussion Paper DP 2008–04, 2008.

internal market and more competition in the European energy supply sector. Many see unbundling in a wider context, which includes the competition law based doctrine of essential facilities or indispensible *infra*structures, which mandates access to essential *infra*structures in individual cases.[48] Often, the regulation of access to the energy networks, which provides for so-called Third Party Access (TPA), is also discussed as an inseparable supplement to unbundling.

It is important to note though that network access regulation and unbundling are two separate regulatory instruments. The introduction of more intrusive forms of unbundling as regards the structure of energy supply undertakings (ESUs) is usually the consequence of allegedly insufficient regulation of network access.[49] Unbundling as the subject matter of this research is understood as the structural reorganization of vertically integrated ESUs, in particular its network *infra*structure, which covers electricity grids and gas pipelines, on which this work focuses, as well as Liquefied Natural Gas (LNG) facilities and gas storage. It is supposed to supplement network access regulation in order to achieve transparency in the operation of vertically integrated ESUs, which in turn should enable non-discriminatory energy network access. In addition, unbundling is perceived as an adequate tool to prevent hidden or internal cross-subsidization in the vertically integrated ESU, which in turn is alleged to cause distortion of

48 See in greater detail, Part 1 Chapter 2.

49 Which becomes particularly obvious in the energy sector. In 1996 and 1998, when the first generation of Energy Directives (Directive 96/92/EC of 19 December 1996 concerning common rules for the internal market in electricity ("1996 Electricity Directive"), OJ 1997 L 27/20, 30.1.1997, and Directive 98/30/EC of 22 June 1998 concerning common rules for the internal market in natural gas ("1998 Gas Directive"), OJ 1998 L 204/1, 21.7.1998) established relatively weak network access regulation, the institutional side in terms of regulatory supervision was rather underdeveloped, and TPA was the result of a negotiation process. In the telecommunications sector, by contrast, network access and price regulation was introduced together with a regulatory authority equipped with more effective regulatory instruments, see P Larouche, *Competition Law and Regulation in European Telecommunications*, 2000, L Hancher, 'The New European Energy Policy. Future challenges – future regulatory frameworks?', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports IV*, 2007, chapter 5. As a consequence, unbundling measures have been largely confined to accounts unbundling, which is defined *infra*. More generally, it can be said that the more intrusive network access regulation is, the less intrusive forms of unbundling have to be employed and vice versa.

competition on related up- and downstream markets[50] as well as a lever of market power into these markets (monopoly leveraging).[51]

I. MANDATORY UNBUNDLING AS INTERFERENCE WITH STRUCTURE OF UNDERTAKINGS

Unbundling[52], or separation, means the restructuring of traditionally vertically integrated supply undertakings featuring network inputs in the form of *infra*structure necessary to supply customers and end consumers with services like telecommunications, energy, postal or rail transport services. When liberalization started, the European energy (electricity and gas) supply industry was traditionally characterized by state monopolies or undertakings, on which the State had conferred a legal monopoly. These undertakings were active in all areas of energy supply, from electricity generation and gas production to operating (often their own) system of grids and/or pipelines, and trading and supply. In other words, the European energy supply sector has been characterized by vertically integrated undertakings.[53]

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50 Which means markets grouped around the network facility or input and being part of the relevant supply chain, in the case of electricity and gas upstream (wholesale) generation/production and downstream supply, retail or operational activities, see also section B. See also with regard to related markets in general, i.e. up- and downstream, the Commission Decisions (IV/34.174) of 11 June 1992 – *B&I Line plc* v *Sealink Harbours Ltd and Sealink Stena Ltd ("Holyhead") – Interim measures*, (1992) 5 Common Market Law Reports (C.M.L.R.) 255, and (IV/34.689) of 21 December 1993 – *Sea Containers* v *Stena Sealink – Interim measures*, OJ 1994 L 15/8, 18.1.1994 .

51 See, however, Willems/Ehlers, n. 2, who doubt that cross-subsidization on its own without further accompanying anticompetitive practices or being embedded in such is something to worry about.

52 For further terminology and definitions in the context of unbundling, see OECD, 'Restructuring Public Utilities for Competition', Paris, 2001, pp. 12–19. The separation into reciprocal parts, *ibid*., pp. 16–7, and the separation of non-competitive components into smaller parts, *ibid*., pp. 17–8, are not applicable in the context of European energy supply markets liberalization.

53 Meaning an undertaking or a group of undertakings (thereafter 'undertakings') whose *mutual relationships* are defined in Article 3(2) Merger Regulation, n. 19, and where the undertaking/group concerned is performing at least one of the functions of transmission or distribution (in case of gas also liquefaction of natural gas (LNG) or storage), and at least one of the functions of production/generation or supply of natural gas/electricity. From this it follows that three constellations of vertical integration are possible, e.g., a combination of generation/production, transmission and/or distribution (and/or LNG and/or storage) and supply, a combination of production/generation and/or transmission and/or distribution and a combination of transmission and/or distribution and supply.
Mutual relationships as defined in Article 3(2) Merger Regulation means control (see already n. 19) conferring the possibility of exercising *decisive influence* on an undertaking. Further, the 2003 Energy Directives define 'related undertakings' as *affiliated* undertakings (within the meaning of Article 41 of the Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54(3)(g) of the Treaty on consolidated accounts, OJ 1983 L 193/1, 18.7.1983), and/or

A core feature of unbundling is the interference with the structure of an undertaking, which is effected by a pre-defined separation of formerly integrated components. The intensity of such interference depends on the specific form of unbundling chosen.

Unbundling is therefore rather distinct from granting access to the energy networks or regulating its terms and conditions. Unbundling in the context of energy supply market liberalization is exclusively concerned with the restructuring of undertakings with the aim of hiving off their networks, which are (generally perceived as) natural monopolies[54], in order to create or support competition in those non network activities, which albeit potentially competitive were artificially held by monopolies, i.e. the upstream markets of electricity generation and gas production, and the downstream markets of energy trading

associated undertakings (within the meaning of Article 33(1) Directive 83/349), and/or undertakings which belong to the *same shareholders*.
The definitions of vertically integrated and related undertakings can be found in Article 2 nos 20, 22 Gas Directive 2003 and Article 2 nos 21, 22 Electricity Directive 2003. Both Directives also allow combined transmission and distribution (and LNG and storage in the case of gas) operators, as well as horizontally integrated undertakings comprising of (commercial) gas and electricity (and other non-electricity and non-gas) activities.

54 A natural monopoly exists when it is economically or physically impractical (or undesirable) for more than one entity to perform a service in a given market, or in more economic terms, if a single supplier can serve a relevant market more cost-efficiently than several suppliers. Consequently, the cost function in the relevant area of supply is sub-additive. Sub-additive means that unit costs are falling with output level. Examining the cost side of networks, bundling economies based on economies of scale and scope stand out, which can cause a single network supplier to supply more cost-efficiently than several suppliers. See G Knieps, 'Wettbewerb auf den Ferntransportnetzen der deutschen Gaswirtschaft – Eine netzökonomische Analyse', (2002) ZfE 171, 172; P de Bijl, E van Damme, P Larouche, 'Regulating Access to Stimulate Competition in Postal Markets?', TILEC Discussion Paper DP 2005–026, August 2005, p. 11. M Motta, *Competition Policy*, 2004, p. xviii, defines situations in which a natural monopoly persists as markets where fixed costs are so high that no more than one firm would profitably operate. Natural monopolies typically occur in industries where a proportionately large capital investment is required to produce a single unit of output. See also J Tirole, *The Theory of Industrial Organization*, 1988, pp. 19–21. Firms controlling a natural monopoly are widely perceived as *dominant* undertakings in the sense used in Article 82 EC, which play a predominant role in the Part 1 Chapter 2 of this work. Knieps, *ibid*., however, classifies only so-called monopolistic bottlenecks as dominant. A monopolistic bottleneck facility exists if, first, a facility is indispensable in order to reach a customer, hence if there is no second or third such facility, i.e. no active substitute. This is the case if on the basis of bundling economies, there is a natural monopoly situation. Secondly, at the same time, the facility cannot be duplicated at a reasonable cost in order to competitively discipline the active supplier, i.e. there is no potential substitute available. This is the case if the cost of the facility are sunk or irreversible and, as a consequence, there is no functioning second hand market for this facility, Knieps, *ibid*., pp. 172–3. See also L Hancher, 'Case C-7/97, *Bronner* v. *Mediaprint*', (1999) CML Rev. 1289, 1300, 1304–5. By applying this to the German gas transmission networks, Knieps, *ibid*., concludes that these do not display monopolistic bottleneck characteristics and, thus, should not be classified as dominant.

and supply to costumers and end consumers, to which the energy networks are essential inputs.[55]

II. FORMS OF UNBUNDLING

There are several forms of unbundling, which can be distinguished with respect to their effects on and intensity of interference with the structure of ESUs.

1. Unbundling of accounts

When unbundling of accounts is required, ESUs have to keep separate accounts internally for both their transmission and distribution activities, as they would be required to do if the activities in question were carried out by legally separate undertakings.[56] This means in turn that the ESU can keep its current business model and legal form, only the internal structure of its accounting changes. For each of its transmission and distribution activities respectively, a separate and full balance sheet and a profit and loss statement have to go into the annual accounts of the ESU. Revenue from ownership of the energy networks must be specified in these accounts. Additionally, gas supply undertakings have to specify in their internal accounting the rules for the allocation of assets and liabilities, expenditure and income as well as for depreciation, without prejudice to national accounting rules, which they have to follow in drawing up separate accounts.[57]

The unbundling of accounts can be compared with the segmentation often displayed in group annual accounts. The basic idea behind this form of unbundling, which demands the breakdown of individual supply activities, is to create transparency of the internal processes of ESUs including the uncovering of cross-subsidization.

2. Organizational or functional unbundling

This kind of unbundling is more intrusive than accounts unbundling and prescribes the restructuring of individual but integrated activities of ESUs into separate activities. This means that the activities, which are accounted for

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55 The integration of up- and downstream electricity and gas supply, or in other words between energy wholesale and retail businesses, exclusive of energy networks can also be called "vertical integration". And although this sort of vertial integration plays some role when looking into the consequences of possible competition law enforced divestiture of energy networks (Part 1 Chapter 2), it is, similarly to long-term contracts (LTC), see n. 43, *not* subject of this work.

56 Article 19(3) Electricity Directive 2003, Article 17(3) Gas Directive 2003.

57 Article 17(5) Gas Directive 2003.

separately, have to be organized wholly or in part in separate departments. Such departments remain within the ESU and do not have to be spun off as subsidiaries. Consequently, they are still controlled and directed by the management of the ESU.

Usually, these departments must obey confidentiality, i.e. they are not allowed to exchange information and have to pursue their tasks without communicating with each other. This sort of unbundling is called informational unbundling or "Chinese walls".

The purpose of informational unbundling is to prevent one department from using commercially advantageous information of another department of the same ESU to the detriment of third parties, thus being able to discriminate against them. Organizational or functional unbundling does not only serve as a control mechanism against discriminatory behaviour like accounts unbundling, which can only uncover internal cross-subsidization *ex post*, but it is also supposed to actively stop discriminatory conduct.

Thus, organizational unbundling is often introduced together with accounts unbundling. By doing this, both financial discriminations such as internal cross-subsidizations and other forms of discriminatory conduct are in theory prevented.

3. Legal or corporate unbundling

Legal or, as the OECD calls it[58], corporate unbundling goes even further. Here, the internal separation of departments does not suffice; they have to be incorporated as legally independent subsidiaries. Such legal separation is supposed to prevent the cooperation between the departments so separated and, thus, internal cross-subsidization. As a result, the activities so separated have to report their annual accounts independently, not just internally as in the case of accounts unbundling. The advantage of legal unbundling is legal independence, which allows the choice of different valuation methods within the respective balance sheets, and clear segmentation of the different activities of vertically integrated ESUs.

On the other hand, even with legally unbundled activities, it remains possible to exert commercial influence on individual subsidiaries and to urge them to coordinated conduct; the degree of such potential influence varies depending on the interrelationship of the subsidiaries amongst each other and, more importantly, with their holding company.

58 See n. 52.

Legal unbundling of network operation (together with management unbundling, see below) is the degree of unbundling prescribed by the second generation of Energy Directives (of 2003).[59]

Legal unbundling of the network activities of ESUs can basically be pursued in two different ways: either the legal ownership of the networks is transferred to the network operation subsidiaries (often referred to as "fat" legal unbundling), or it remains elsewhere in the group (often referred to as "slim" or "lean" legal unbundling).[60]

4. Management or operational unbundling

Whereas legal unbundling is merely the formal requirement of operating the energy networks in a subsidiary separate from the remaining vertically integrated energy supply undertaking, every aspect exceeding legal unbundling of the network operations required by the 2003 Energy Directives, i.e. the designation of personnel to the network operation subsidiary, the boundaries, within which the vertically integrated ESU can exert influence on the network operation subsidiary, the company law related supervision and direction powers, the allocation of responsibilities and competencies and the extent of control of the networks operations are exclusively a matter of operational or management unbundling. As legal unbundling in itself is not sufficient because the ESU would not be prevented to put the network operation and the other supply activities in the same hands in terms of management, personnel and decision-making rights.[61]

Management or operational unbundling involves the obligation of ESUs to employ those of the management and personnel who are predominantly preoccupied with activities relating to energy network operations, within that specific network operation division. This should enable those staff to act independently from the other supply activities of the ESU, and a guarantee is also required that such personnel and the personnel of the reminder of the ESU are treated equally.[62]

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59 Article 10(1) (transmission) and 15(1) (distribution) Electricity Directive 2003, Article 9(1) (transmission) and 13(1) (distribution) Gas Directive 2003.

60 For the use of this terminology, see I Brinkman, 'The Unbundling of Gas and Electricity Distribution Grids in the Netherlands – the Pros and Cons of a Controversial Policy Intention', in M Roggenkamp, U Hammer (eds), *European Energy Law Report II*, 2005, chapter 10, p. 149, and Mulder/Shestalova/Lijesen, n. 37, pp. 79 *et seq*.

61 J Eder, 'Entflechtung §§ 7 und 8 EnWG', in Danner/Theobald (eds), *Energierecht – Kommentar – Gesetz über die Elektrizitäts- und Gasversorgung (Energiewirtschaftsgesetz)*, 2006, B1 § 7 EnWG I nos 3 and 4. Operational (as opposed to organizational) unbundling without legal unbundling would conflict with the overall responsibility of the general management of the vertically integrated undertaking.

62 *Cf.* Article 10(2b) (transmission) and 15(2b) (distribution) Electricity Directive 2003, Article 9(2b) (transmission) and 13(2b) (distribution) Gas Directive 2003. Operational

Further features of operational unbundling are reflected in the 2003 Energy Directives, which stipulate that persons responsible for the management of the networks may not participate in such organizational parts of the integrated energy supply undertaking as are directly or indirectly responsible for the day-to-day operation of the other supply activities of the ESU. The energy network operator shall have effective decision-making rights, independent from the integrated ESU, with respect to assets necessary to operate, maintain or develop the network. Such rights should not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets in a subsidiary are protected.[63] This shall in particular enable the parent company to approve the annual financial plan, or any equivalent instrument, of the network operator and to set global limits on the levels of indebtedness of its subsidiary. It shall not permit the parent company to give instructions regarding day-to-day operations, nor with respect to individual decisions concerning the construction or upgrading of networks, that do not exceed the terms of the approved financial plan, or any equivalent instrument (financial independence).[64]

The requirements of legal and operational unbundling complement one another but do not overlap. Both forms of unbundling serve the purpose of having the network operations within a vertically integrated ESU administered by a largely independent network division.

5. Forms of ownership unbundling

a. Introduction

In the current discussion, i.e. on the basis of the 2003 Energy Directives[65], which require the legal unbundling of energy network operations[66], ownership unbundling lacks clear definition. The term ownership unbundling is used in different contexts and often reflects particular demands placed upon the

unbundling generally includes all measures serving the internal separation of integrated activities, i.e. those measures, which serve the strict separation and independent accountability of the activities concerned. Personnel of the activity concerned only report to the management of the respective internal activity.

63 Obviously a scenario of combined legal and operational unbundling.

64 Articles 10(2) (transmission) and 15(2) (distribution) Electricity Directive 2003, Articles 9(2) (transmission) and 13(2) (distribution) Gas Directive 2003.

65 That is, directly unchallengeable. The question of a possible implicit assessment of voidness of the 2003 Energy Directives, i.e. within court proceedings where the subject matter requires, inter alia, this assessment will not be discussed.

66 The following discussion is based on the assumption that energy network operations are already or will soon be transferred to a separate legal entity within the vertically integrated energy undertaking. The fact that the 2003 Energy Directives contain *de minimis* exceptions to the legal unbundling requirement will be disregarded.

operation of energy networks. The variety of meanings attached to the term ownership unbundling when used in such contexts often imply different levels of interference with the ownership of energy networks. From the viewpoint of a vertically integrated ESU, various levels of interference with its ownership of networks can be distinguished. The following forms of ownership unbundling are arranged in the order of decreasing intensity of interference[67]:

b. Separation of network undertaking[68] from remaining energy supply group

aa. Nationalization of network undertakings

The most rigid form of ownership unbundling is the nationalization of network undertakings or the taking-over of such undertakings by the State in order to transfer them to third parties unrelated to the energy supply group (thereafter "group").[69] Unless selling their networks to the State voluntarily, the State can only deprive network owners or their shareholders of their networks by way of formal expropriation[70], i.e. by law or based on law, in order to nationalize (or redistribute) their networks. This form of ownership unbundling is characterized by the total loss of ownership. The network owner, who faces such deprivation[71], would not even be able to choose the purchaser of the network. This and the following form of deprivation are the further unbundling measures the European Commission aims at in their legislative proposals.

bb. Disintegration of network undertakings by forced sale

The forced sale or mandated divestiture to third (private) parties to disintegrate the energy networks from the other energy supply activities of production/generation and supply would be an alternative route to the nationalization of the energy networks.

This strict form of ownership unbundling would not only involve the separation of the legal ownership of the networks from the legal ownership of production/generation and supply but also its transfer to an undertaking, which is wholly independent from the group. This means that the ownership in both the network

67 As to the degree of interference in ownership rights, see section C. III. *infra*.

68 Comprising of network ownership and network operation. Depriving vertically integrated energy supply undertakings of the legal ownership of their energy networks but allowing them to operate these networks would not alleviate the competition concerns and is thus not discussed here.

69 Group in this context means the vertically integrated ESU itself and its owners/shareholders including any ultimate owners/shareholders.

70 The term "expropriation" is explained in Part 2.

71 The term "deprivation" is explained in Part 2.

undertaking and the group is not allowed to be held by the same shareholders. The aim of this form of ownership unbundling is the disintegration of the ownership of the energy networks and their operation on the one hand from that of energy production/generation and supply on the other.

The core intention of this measure to prohibit the direct or indirect holding of shares in, or control in the form of a decisive influence on, the undertaking active in network operation and the group active in production/generation and supply. Such a prohibition also covers immediate and intermediate shareholdings up to the ultimate shareholder level. A combination of network operation, production/generation and supply under the same holding would therefore be prohibited. Additionally, the network operation would also have to own the network it is operating.

As regards the possible admission of cross-shareholdings[72], different levels of restriction would be possible: the strictest form would be the absolute prohibition of any cross-shareholdings. This would only be possible in the context of nationalization. In the case of a listed public limited company, for example, (a certain percentage of) shares (is) are usually free float, thus any restrictions preventing one of the shareholders from holding cross-shareholdings would be rather difficult to achieve, or at least to control.[73]

Less rigid and thus easier to control would be a prohibition on majority or controlling or blocking minority cross-shareholdings only. The aim would be to allow only majority shareholdings in production/generation and supply or network operation and minority shareholdings in the network undertaking or vice versa (or even stricter, following the Commission proposals, by not allowing more than minority shareholdings in both activities)[74], such that the minority shareholding is not a blocking minority. It would also have to be ensured that *de facto* influence cannot occur, for instance in shareholders' or annual meetings.[75]

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72 Cross-shareholding in the given context means the mutual shareholding between undertakings pursuing activities within the vertical energy supply chain (group prohibition).

73 See in this respect the NationalGrid and its licence prohibitions, Part 2 Chapter 5 on Great Britain.

74 The majority/minority combination would, according to the Commission's share split proposal mentioned in section A I *supra*, result in the compulsion of the holder of a majority and a minority stake to sell one of his stakes within a certain period of time.

75 A definition of *de facto* influence can be found in Article 3 (3) Merger Regulation: "Control is acquired by persons or undertakings which: (a) are holders of the rights or entitled to rights under the contracts concerned; *or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom* (emphasis added)." Equally, "collusive" or joint control or blocking minorities of several holders of minority stakes (similar to club ownership), which in themselves are neither controlling nor blocking would also have to be prevented. See also nn. 19, 53.

Forced sale differs from expropriation in that the former does not deprive the owner of its ownership directly by way of State action with the consequence of an immediate transfer of ownership to the State. The owner can choose the purchaser (unless being forced to sell to a national network operator, see below) and negotiate the purchase price.

However, the forced sale is only a milder alternative to expropriation on the face of it. The choice of a purchaser is actually the only right the owner retains. It must sell within a time frame imposed by law; there is no choice of the most advantageous point in time. Thus, the owner bears the full risk. The sale of the network and use of the price achieved is the only property right retained. Additionally, because the owner is forced to sell, potential purchasers might take advantage of this situation and try to buy the network for an inadequate price.

It is for these reasons that forced sales are explicitly dealt with in the same way as expropriations, since there is, as in the case of ownership separation by way of expropriation, no alternative exercise of ownership rights possible.

cc. National transmission system operator owning energy networks

The concept of national energy network operators is usually only concerned with the transmission grid and pipeline system. In the Netherlands, for example, state-owned TenneT is the national electricity transmission system operator whereas state-owned Gas Unie runs the national gas transmission pipeline network. Slightly at variance is the Great Britain (GB – England, Wales and Scotland) electricity transmission system operator National Grid plc, which since privatization owns the transmission grids in England and Wales but not in Scotland. On the other hand, since 2002 a subsidiary of the same company owns and operates the gas transmission grid throughout Great Britain. These energy transmission system operators are normally not involved in the operation of the energy distribution networks, except, again, for National Grid, which also operates some of the gas distribution pipelines in GB.

A special feature of this particular variation of ownership unbundling is that the energy networks concerned are operated by one single undertaking. Within this concept the degree of ownership unbundling can vary depending on whether the national energy network operator also is the actual legal owner of the networks and who the shareholders of such a network undertaking are.

Requiring the national network operator to become the legal owner of the energy networks means that the vertically integrated ESUs owning such networks would be forced to transfer them, which would correspond to the form of ownership

unbundling discussed before.[76] This normally also means that the ESUs would lose the sole control over the networks they used to own. This would also be the case if the current network operators became shareholders of the national energy network operator. Although they might receive shares in the national energy network operator in consideration for the transfer of their networks, such shareholdings are likely to be minority shareholdings only, with the consequence of losing the sole control of the networks they previously owned and controlled alone.[77]

Another variation would be that the national energy network undertaking does not have to be the legal owner of the national energy transmission networks but is solely responsible for the independent operation of such networks. As a result, the right to use these networks is conferred upon such an undertaking by law or at least the right to control the operation of these networks (such as the power to give directions or to interfere with the use of the networks), or the network owner would be obliged to grant such rights on a contractual basis. Thus, the current network operators could formally remain owner of the networks but their right to use and control the networks would be further limited (compared to the current state of legal unbundling). Such a solution has been favoured for the electricity transmission networks in Scotland. The Commission takes this idea further by proposing, as an alternative to ownership unbundling, the establishment of "deep" ISOs (see already in section A(I) above), which are also solely responsible for deciding and organizing (new) investment into the energy networks they operate.[78]

c. Forms of ownership unbundling within an energy supply group

The second generation of Energy Directives (of 2003) clarifies that the implementation of legal unbundling does not require the transfer of the legal ownership of assets of the networks from the vertically integrated ESU to the

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76 Apart from the fact that in the previous model, the ESU theoretically has, within a certain time limit, a choice as regards the finding of a purchaser of the network.

77 In Germany, the four current electricity transmission network owners are planning to establish one national transmission operator under club ownership, see Spiegel, 'Stromversorger planen gemeinsames Stromnetz', 23 September 2008. On club ownership, see OECD, n. 52, pp. 13–4.

78 In the Netherlands, by contrast, large parts of the electricity and the complete gas transmission networks are in the hands of the State and also operated by state-owned operation companies. Many of the remaining electricity transmission networks (from 110 kV upwards) not owned by the State directly but by vertically integrated undertakings owned by municipalities as subdivisions of the State, are, however, also under operation of the state-owned electricity transmission network operator TenneT, which in turn is responsible for network extension and investment. See in greater detail, Part 2 Chapter 6 on the Netherlands.

undertaking operating the networks.[79] Only the network operations and the essential decision making rights with respect to the networks have to be transferred to such an undertaking, which can still be affiliated to the remainder of the vertically integrated energy supply group.

Ownership unbundling in this context could mean that the still integrated network operation undertaking[80] also has to be the legal owner or economic "owner"[81] of the networks.[82] Four scenarios are possible:

(1) The undertaking operating and being the legal owner of the network is required to be separated from the vertically integrated ESU (no cross-shareholdings allowed) but may be owned by shareholders both undertakings have in common.[83]
(2) The undertaking operating the network and being the economic "owner" of the network is required to be separated from the vertically integrated ESU (no cross-shareholdings allowed) but may be owned by shareholders both undertakings have in common.[84]

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79 Article 10(1) 2nd sentence Electricity Directive 2003. This gives an indication of what the EC legislator considers ownership unbundling to be.

80 Assuming that network operation is legally unbundled.

81 "Economic" unbundling is a term used in current Dutch energy legislation and referred to in the so-called *splitsingswet* (Wet van 23 november 2006 tot wijziging van de Elektriciteitswet 1998 en van de Gaswet in verband met nadere regels omtrent een onafhankelijk netbeheer, (2006) Staatsblad van het Koninkrijk der Nederlanden 614), see Part 2 Chapter 6 on the Netherlands. Economic ownership is defined in the Dutch Electriciteitswet 1998 (Electricity Act 1998 – "E-wet") as amended on 14 July 2004, (2004) Staatsblad van het Koninkrijk der Nederlanden 443, Artikel 1(1)(aa), and the Gaswet (Gas Act – "G-wet") as amended on 14 July 2004, (2004) Staatsblad van het Koninkrijk der Nederlanden 444, Artikel 1(1)(u), as the entitlement based on a legal relationship to all rights and competences with respect to a good, with the exception of the right to deliver (transfer the title to the good), and the responsibility for all obligations with respect to that good including the assumption of the full risk of a change in value or total loss of the good, without the good having been delivered ("[…] economische eigendom: het krachtens een rechtsverhouding gerechtigd zijn tot alle rechten en bevoegdheden ten aanzien van een goed, met uitzondering van het recht op levering, en het gehouden zijn om alle verplichtingen ten aanzien van dat goed voor zijn rekening te nemen en daarmee het volledige risico van waardeverandering of tenietgaan van het goed te dragen, zonder dat het goed geleverd is. […]"). This is to some extent comparable to equitable beneficial ownership or trusts as known under common law, or to Sicherungseigentum or Treuhand under German law. Important to note here, however, is the complete independence of the economic "owner" from the legal owner.

82 Depending on the details of the organizational requirements imposed upon the vertically integrated ESU (organizational or functional unbundling, see *supra*), the network undertaking could be a subsidiary, sister undertaking or even the parent of the production/generation and energy supply undertaking(s) within one group of vertically integrated energy supply undertakings.

83 Such (ultimate) shareholders are either natural persons, or the State or public entities or subdivisions of the State such as municipalities.

84 Thus, the formal legal title, which (in theory) still attaches to the remaining ESU, would only be of little value. This is envisaged by the Dutch *splitsingswet* (see Part 2 Chapter 6 on the

(3) The shares in the vertically integrated undertaking operating and being the legal owner of the network are required to be held by a neutral trustee, who could even be appointed by the regulatory authority[85]; the influence of the shareholders would thus be significantly reduced or even eradicated safeguarding the independence of (the board(s) of) the vertically integrated network undertaking from the shareholders' interference: the shareholders would lose any (direct) supervisory oversight over the management of the network operator, which operates with their assets and financial means. Although the trustee would be accountable to them, the only direct power they would retain with respect to the undertaking they own is the right to receive dividends.

As a longer-term solution, this variation might conflict with company law, more specifically corporate law as usually vertically integrated energy undertakings are incorporated as (public or private) limited companies (if not state integrated public bodies), because of the permanent separation of participation rights from the shareholding. Consequently, this form of unbundling might have to entail the amendment of company law if as is normally the case in corporate law such a separation of powers is forbidden under the relevant Member State company law legislation.[86] It leaves the formal ownership of the networks and any profits made in the vertically integrated undertaking but essential decision-making rights would transfer to the trustee.

Usually, the trustee would exercise the shareholders' rights he holds in shareholders' meetings. Additionally or alternatively, he would (participate in) the appointment of supervisory board members (in a two-tier company law system such as Germany) or non-executive directors (in one-tier company law systems such as the UK), or be installed as supervisory board or non-executive director himself (he may or may not be a trustee of the shareholders' rights at the same time).

The "Third Way" of further unbundling mentioned in section A(I) above would come close to this scenario. The incompatibility of this scenario with corporate law, however, is an issue, which, as long as it does not go beyond the legitimate regulation of the right to property, should not pose too great a problem to the legislature because corporate law in itself is predominantly the regulation of property. This is explained in greater detail in Part 2 Chapter 4 section V on Germany.

Netherlands). See also n. 75.

85 This variation is what the OECD calls operational unbundling, see OECD, n. 52, pp. 14–5, defining it as separation of ownership and control.

86 *Cf.* J Baur, K Pritschke, S Klauer, *Ownership Unbundling*, 2006, p. 34.

(4) The vertically integrated undertaking currently just operating the network are required to be the legal owners or at least the economic "owners" of the networks they are operating but are allowed to remain within the vertically integrated ESU.

As can be observed, ownership unbundling can also implemented in the form of restrictions of ownership rights, which exceed the restrictions imposed by legal unbundling. This means that any exertion of influence, which still exists in the form of supervisory powers, on the legally unbundled network operator is reduced even further.

III. THE FORMS OF OWNERSHIP UNBUNDLING AND THEIR DIFFERING DEGREE OF INTERFERENCE WITH ENERGY NETWORKS OWNERSHIP

As the fundamental right to property is the focus of this work's evaluation of the interference of the various forms of ownership unbundling with fundamental rights, the main components of the right to property from an economic or business perspective are now briefly outlined to appreciate the intensity of their interference with this right.

1. Scope of right to property[87]

First of all, the right to property comprises the private owner's right to use the property and to dispose of such assets, i.e. the right to use and the right to dispose. Further, the property right comprises of the right to deal with the property however the owner pleases and to exclude third parties from any interference. Thus, the right of the owner to do whatever he pleases is a right with positive effect, for instance to chose the form of ownership transfer, to give up ownership, to encumber property and to control its use, to possess, use or not use, to change, consume of destroy the property. The corresponding right to exclude any interference by third parties with the asset owned, in contrast, is a right with negative effect and mainly concerns interferences like seizure, destruction, damage or use by third parties.

With regard to energy networks, the positive effect just described means that the owner(s) are free to dispose of the network or parts thereof to a self-chosen purchaser, to burden it and use it as collateral, to use it and to determine the construction, extension, change and decommissioning. The same is true for any

87 See Depenheuer in Tettinger/Stern, *Kölner Gemeinschaftskommentar zur Europäischen Grundrechte-Charta*, 2006, Article 17.

shareholding in a subsidiary (making the shareholder the owner of the subsidiary), which is responsible for operating the network within the vertically integrated ESU. The owner's right to use the property himself is particularly reflected in the right to receive the profits made, (within the limits of company law) to freely determine the internal structure of the undertaking, to decide about the use of invested capital, the company's organization, to discharge its management (board), and to implement internal rules such as the articles and memorandum of association and the directions concerning the day-to-day business.

The negative effect of the right to property primarily concerns the assets which belong to the network. Here, the freedom to exclude third parties from using the network is of importance, or at least the determination of the rules for third party access. The latter freedom has already been significantly restricted by network access regulation and, more generally, by the competition law prohibition on abuse of one's dominant position. As the owner's right to use his property is of commercial importance in that the right to profit from the asset is derived from this right, the regulation of network access charges also affects property rights.

A further power contained in the right to property is the right to exercise control, in particular the control powers of shareholders of the company they hold shares in, i.e. the power to determine how to proceed with the company's property. Control can be defined as the capacity to exercise decisive influence on an undertaking[88], on its strategic commercial behaviour. Consequently, the right to exercise control overlaps to some extent with the owner's power to dispose of and use its assets, as the latter two powers do with each other.

From an economic perspective, the following essential characteristics of the right to property can thus be established:

- the right to have control over the property as a consequence of the positive right to deal with the property however the owner pleases;
- the right to use the property, for instance by way of deriving profit from it; and
- the right to dispose of the property, i.e. to sell this property to third parties of the owner's choice.

2. Effect of various forms of ownership unbundling on ownership rights

As we have seen above, legal unbundling already interferes directly with the control and determination rights of the owner(s) of the network or the network

88 See the definition of control in the context of the Merger Regulation, nn. 19, 53.

undertaking in that a particular corporate structure is required, i.e. the network operation has to be transferred to a separate company, and in that this company moreover must be granted a certain range of independent decision-making rights. However, as a matter of definition, the interference of ownership unbundling with property rights exceeds the interference of legal unbundling.

Ownership unbundling leads to different restrictions on the elements of the right to property outlined above, i.e. the powers to use, to control and to dispose of the property. Not every variation of ownership unbundling interferes with every element of the property right but might just restrict some of them.

a. Separation of network undertaking from energy supply group

These forms of ownership unbundling place restrictions on all three elements of the right to property: the right to dispose of the property is interfered with because the actual owners of the network or the network undertaking are required to give up the direct or indirect ownership of the network or the majority shareholding in the network undertaking. These owners are forced to dispose of the network assets or shares in the network undertaking. As a result, the rights to use and control the property are also substantially restricted or even lost. The right to receive dividends and to participate in the profits made in the course of operating the network is reduced because of the reduced or even lost ownership of the network undertaking. The owner is forced to give up all or his sole or majority rights with respect to the network. This becomes the more obvious if control as defined in the EC Merger Regulation[89] is made the criteria for the way and the extent to which the network has to be sold.

Nationalization, as the gravest interference with the right to property, results in the loss of the right to disposal, the right to exercise control and to an almost complete deprivation of the right to use the property. What remains of the latter right is a claim against the State to pay compensation.

In the first variation of ownership unbundling (i.e. the form of creating a national transmission system operator owning the energy networks), all three parts of the property right are restricted as well. Again, the disposal of the network is mandated, and the current sole or majority rights to use and control the network are reduced to minority participations.[90]

89 See n. 19.

90 The other variation of a national network operator is different in that the ownership of the network can stay with the current owner, which means that the right of disposal is not necessarily restricted. Only the rights to use and control have to be transferred to the national network operator. Financially, the right to use the network stays with the current owner

b. Forms of ownership unbundling within an energy supply group

If, in the context of ownership unbundling within the group, the only requirement additional to mandatory legal unbundling is that the network undertaking must be the owner of the network, all three parts of the right to property are interfered with although in a substantially reduced manner.[91] Unless the current network owner is not the network operator, it is required to dispose of the network by transfer to a separate undertaking. This undertaking, however, can be part of the group. The right to control is thus restricted insofar as the former owner now only exercises, if any, indirect control over the network, i.e. by way of controlling the undertaking onto which the network property has been transferred.

If one does, however, not strictly focus on the person who has so far been the owner of the network when assessing the intensity of intervention, but looks at it from a commercial point of view, then the interference with property rights is less intrusive than is the case with the forms of ownership unbundling outlined before. This is because all ownership rights stay within the vertically integrated group. The profits made by the network undertaking still fully belong to the vertically integrated group. Any restrictions on property rights in the context of this form of ownership unbundling are thus mainly attributable to the mandatory legal unbundling and the regulation of the network access charges.

The variations in section C(II)(5c)(1)-(3) entail restrictions on all three elements of the right of property. Again, a disposal is required because all three variations require either the network assets or the shares in the network undertaking to be transferred to the shareholders (of the vertically integrated ESU), or at least the shareholders' right to participate in decision-making in case of appointing a trustee. If (the holding of) a vertically integrated ESU has the shares in the network undertaking, the disposal is accompanied by the loss of the rights to use and control the network. This restriction, however, appears to be less intrusive in as far as, financially, the right to use would remain with the (ultimate) shareholders and the right to exercise at least some control would continue to exist (either directly at (ultimate) shareholder level or indirectly through a holding placed between the (ultimate) shareholders and the network undertaking).[92] In the

because the profits deriving from the operation of the network stay with the owner, which is substantially different from the Dutch "variation" of economic "ownership", see n. 75 and n. 78 and accompanying text; see also last paragraph of next subsection (b). But the remainder of the right would have to move to the network operator, which must have the power to give detailed directions as to the way the network is to be used and operated.

91 See variation in section C II 5 c (4) *supra*.

92 The term "deprivation" is explained in Part 2.

trustee variation though, the rights to use and control would again be significantly restricted.

3. Summary

It has been established that the forms of ownership unbundling, which only restructure the ownership relationships within the group, are the least intrusive and come close to legal unbundling. Consequently, they appear not to interfere too gravely with the right to property, at least when looking at it from a commercial point of view. By contrast, where ownership unbundling substantially restricts all three parts of the right to property, this normally means the deprivation of property[93] and thus a grave interference with the right to property. Nationalization, in this respect, is certainly the most rigid form of intervention, whereas other forms such as forced sale or transfer of ownership to a national network operator interfere less strongly with the right to dispose of the network property.

Figure 5. Ownership unbundling effects on tripartite right to energy network property

Forms of ownership unbundling / Powers	Separation of network undertaking from group (nationalization, forced sale, national transmission system operator)	Ownership unbundling within group (variations C(II)(5c)(1)-(3)	Ownership unbundling within group (variation C(II)(5c)(4)
Control	excluded	excluded	restricted
Use	– excluded but purchase price – excluded but compensation – excluded (but purchase price) or restricted	restricted	unchanged
Disposal	– forced sale net outside group – expropriation – forced sale net or restricted	excluded	marginally restricted (separate network undertaking)

93 See, however, the extensive analysis of the Dutch variation of economic "owernship" (nn. 75, 78 and accompanying text) and its fundamental rights relevance in Part 2 Chapter 6 on the Netherlands, in particular with respect to the eligibility of public ESUs to fundamental rights protection.

D. RESEARCH QUESTIONS AND OUTLINE

The research presented here is structured into three parts, which will answer the following questions:

Part 1: Economic Regulation

Under the principles of EC economic regulation, can legal ownership unbundling in principle be enforced in the energy supply sector on the basis of EC competition law? In the context of energy supply sector regulation, can the EU invoke its harmonization competence as set out in Article 95 EC to legislate for further unbundling of the energy supply industry in the EU?

In this first part, the economic rationale behind EC economic regulation and thus also European energy market regulation will be outlined and complemented by economic theory underlying European energy market regulation and followed by the evaluation as to whether (primary) EC competition law can justify the enforcement of legal ownership unbundling in the European energy supply industry.

Interlinked with the previous issue, within the context of economic regulation of the European energy supply industry, the further question will have to be answered at this stage whether further unbundling, which exceeds the current requirements, can be legislated for on the basis of the EU's harmonization competence of Article 95 EC.

Part 2: Fundamental Rights

Under the assumption either that there indeed is such an enforceable harmonization competence or that the EC Member States under review here introduce further unbundling measures of their own volition, the second part discusses fundamental rights issues. In this context, the following question will be answered: Does unbundling of their energy supply sectors exceeding the current requirements clash with the (economic) fundamental rights of the constitutions of Germany, the United Kingdom and the Netherlands, and with the fundamental rights protection as afforded by the European Union?

In the light of Part 1, Part 2 evaluates whether energy supply sector specific regulation as economic regulation, which in general is a legitimate restriction of (economic) fundamental rights, in the specific case of unbundling measures, which exceed the current unbundling requirements, is in line with the

fundamental rights protection afforded by the EC Member States under review, and as afforded by the EU itself.

Conclusions: Drawing (Comparative) Lessons

The analysis in the second part of this research leads us to the comparison of the individual results, which answers the question of what conclusions can be drawn for the legitimacy and the prospects of energy supply sector regulation in the EU.

Outline

Following the order of the research questions, **Part 1** of this research first outlines in chapter 1 the theoretical economic rationale behind, and the objectives of, EC economic regulation of the European energy networks, more particularly the internal and competitive market objectives of the EC Treaty as safeguarded by the European Commission. Thereafter, chapters 2 and 3 deal, respectively, with EC competition law enforcement of energy network ownership unbundling and the legislative introduction of further energy transmission network unbundling measures in the EU, which exceed the current unbundling requirements ("further unbundling"), both of which belong to *ex post* EC economic regulation of the European energy supply industry in that they both regulate existing structures and rights.

Based on the assumption that the behaviour and structure of the European energy supply industry as a typical network industry[94] is comprehensively (not necessarily perfectly) regulated, chapter 2 will evaluate whether and to what extent the European Commission as executive organ of the European Union possesses the general competition law competence to enforce ownership unbundling in the European energy supply industry in order to achieve the objective of competitive energy supply in the European Union. The potential competition related conflicts arising between (not necessarily vertically integrated) energy network owners and network access seekers and the reasons on which such conflicts are based are explained. The distinction and relationship between sector-specific regulation (based on EC secondary legislation) and the application of EC competition law (enforcing the primary competition law provisions of the EC Treaty) is explained. Particular emphasis will be placed on the (remedial) proportionality as fundamental principle underlying EC economic

94 For the purposes of this work, network industries or utilities can be defined as those being based on a fixed distribution networks whereby distribution means, in more general terms, transportation of an input.

regulation and on the importance of including economic efficiency in any test of such principle to see whether the enforcement of ownership unbundling of individual energy networks is proportionate. In this context, the preconditions set by the European Commission and the European Court of Justice for mandating network access in individual cases of refusal by energy network owners to grant access (also called Third-Party Access or TPA) will be explored. Further, an abstract cost and benefit framework and empirical (quantitative) economic evidence will be examined to round up the assessment of proportionality of competition law based measures to safeguard non-discriminatory TPA, in particular by way of divestiture or legal ownership unbundling.

As energy supply is a network-bound industry, which requires sector-specific regulation, chapter 3 of Part 1 outlines briefly the evolution and latest status of European energy supply policy and legislation, including the institutional framework, which regulates and supervises the European energy supply industry. This outline includes some details on the approval by the European Parliament on 22 April 2009 of a new legislative package of EC energy supply sector legislation (so-called third generation internal energy market legislation), which will enter into force after passing the Council of Energy Ministers still before or shortly after the European Parliament elections in June 2009.[95] As the latest agreement also allows for ownership unbundling and against the background that energy regulation is situated within the broader context of economic regulation in Europe, the question will have to be answered as to why in other network sectors such as railway, telecommunications and postal services, such far reaching unbundling of the networks has not been required. Thereafter, chapter 3 deals with the competence issue with respect to new energy supply sector legislation, which arises against the background that an explicit competence for an EC Energy Policy does not yet exist. Taking for granted that further unbundling measures can in principle be based upon the harmonization competence in Article 95 EC[96], it will be discussed in greater detail whether this competence can actually be exercised. Here, Articles 295 (rules governing the system of property fall into the exclusive remit of the EC Member States) and 56 EC (fundamental freedom of free movement of capital) will feature prominently.[97]

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95 See already nn. 31 and 33. The package as approved by the European Parliament will most likely not be amended in substance any more. Cut-off date of this work is 1 January 2009. Any later legal or factual changes and amendments such as the one just mentioned have been taken into account to the greatest extent possible.

96 Other possible competences are not discussed. In this respect, see J Baur, A Lückenbach, *Fortschreitende Regulierung der Energiewirtschaft – Eine kritische Stellungnahme zu den Kommissionsvorschlägen zur Änderung der Binnenmarktrichtline Erdgas (98/30/EG)*, VEnergR 105, 2002.

97 The investment regime of the Energy Charter Treaty 1994 (in particular Article 13) will not be part of the analysis. The Energy Charter Treaty (ECT) is a multilateral investment and trade treaty (in force since April 1998), signed or acceded to by fifty-one countries (all EU Member

Thereafter and on the assumption that the European Union indeed possesses an exercisable competence to pass further unbundling legislation, such exercise must also comply with the principle of subsidiarity and proportionality according to Article 5 EC.

Part 2 is based on the assumption either that there indeed is such an enforceable harmonization competence or that one of the EC Member States under review here introduces further unbundling measures on their own volition. In the light of the results of Part 1, Part 2 evaluates whether energy supply sector specific regulation in the specific case of unbundling measures, which exceed the current unbundling requirements, is in line with the protection of economic fundamental rights such as the right to property and the freedom of economic activity (and to choose and pursue an occupation) as afforded by the constitutions of the EC Member States Germany, United Kingdom (Great Britain) and the Netherlands, and finally for the European Union itself with the fundamental rights protection as afforded by the European Union.

The basic structure of the evaluation of the three Member States under scrutiny here[98], which are dealt with in chapters 4–6 of Part 2, follows the following patterns: first, the evolution and structure of network-bound energy supply will be outlined accompanied by the sketching of the sector-specific regulation applicable (sections II). Important in the context of this research is the

States are individual signatories and thus bound to the ECT's obligations directly) plus the European Community and Euratom (as of September 2008) and ratified by all but five signatories (Australia, Iceland, Norway, Belarus and the Russian Federation, the last of which have accepted provisional application of the ECT).

98 The three Member States Germany, the UK (more particularly Great Britain) and the Netherlands have been chosen because they exemplarily show the fundamental differences in regulatory approaches pursued by the EU Member States and because they represent the different and wide-ranging degrees of energy market liberalization efforts in the EU. They also cover a wide range of constitutional systems and approaches in the EU, i.e. monistic and dualistic constitutional systems on the one hand, and approaches to sovereignty on the other, i.e. absolute parliamentary sovereignty in the UK, a constitutional court as guardian of the constitution in Germany, and the surrender of national sovereignty to the international legal order (at least in theory) in the Netherlands. The predominant cause for the dogmatic depth of German fundamental rights protection seems to be the existence of a constitutional court in Germany protecting Germany's very own fundamental rights standard. The concerns resulting therefrom, which are publically acknowledged in the current debate on ownership unbundling, cause experts for energy supply regulation outside Germany considerable headaches and disbelief. One aim of this research is therefore to make the German objections more transparent and easier to comprehend. The Scandinavian countries, which are at the forefront of developing an integrated regional market as a first step towards a fully integrated European energy market, would justify a research project in its own as does Central-Eastern Europe, which comprises of new Member States at the beginning of liberalizing their energy markets. France and Belgium (currently in the process of building a regional market with the Netherlands, Germany and Luxemburg) and the Southern European Member States all have their own peculiarities, which would not integrate well in this research project.

constitutional setting in each of the three Member States (sections III) as it shows in which fundamental legal environment further unbundling legislation is situated. Here, it will become apparent what fundamental rights standard applies in each of the three countries, how "open" each constitution is to European integration in terms of accepting the supremacy of the legal order of the European Union as established by the European Court of Justice and whether national constitutional law is at all applicable to unbundling legislation introduced by the EU. For Germany and the Netherlands, the constitutional role of municipalities is particularly important as these state sub-divisions are heavily involved in network-bound energy supply. Based on the constitutional setting of each of the three countries, the principal fundamental rights issues arising in the context of further unbundling legislation (sections IV) is discussed with a focus on the fundamental right to property. This framework of an individual Member State's fundamental rights protection is then applied to the specific unbundling measures envisaged (sections V). For all three countries and for the Netherlands in particular, the compliance of possible further unilateral measures with EC law requires some consideration (section VI).

Highlighting issues specific to the individual Member State under scrutiny here, in chapter 4 on Germany the role of the constitutional court in Germany as regards the review of the validity of EC legislation in the German jurisdiction (*Solange* & *Maastricht* case law)[99] as well as the status of the Convention for the Protection of Human Rights and Fundamental Freedoms (in short European Convention of Human Rights or ECHR)[100] in Germany will have to be discussed in the context of the constitutional setting (section III). Particular attention has also to be paid to the rather detailed and effective protection of the right to property under the German Constitution and to the question related thereto whether public or public-private subjects (i.e. undertakings under the influence or controlled by public bodies) can enjoy such protection. This will be part of the discussion of the fundamental rights issues arising in the context of further unbundling legislation (section IV). Also relevant in the particular German context is the further unbundling alternative of "Effective and efficient unbundling" (or the "Third Way"), which is also touched upon when the established framework of fundamental rights protection is applied to further unbundling measures (section V).[101]

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99 BVerfGE 37, 271; 73, 339; 89, 155.

100 Convention for the Protection of Human Rights and Fundamental Freedoms 1950 (as amended by Protocol No. 11 with Protocol Nos. 1, 4, 6, 7, 12 and 13).

101 Section V, which naturally also discusses the proportionality of further unbundling measures, is, in this respect structured slightly differently than the proportionality assessment in Part 1 Chapter 2 and the proportionality considerations in the other chapters of Part 2. Here, the focus is on the question of what is possible in the specific German context.

In chapter 5 on the United Kingdom (more particularly Great Britain), when clarifying in the context of the constitutional setting (section III) the fundamental rights standard applicable in the United Kingdom in the light of parliamentary supremacy, the relationship between EC law and its fundamental rights standard, and national law (which, to a large extent, renders the ECHR applicable in the UK) is of relevance. It is in this chapter 5 that the ECHR protection of the right to property will be discussed (section IV). These elaborations are then complemented in the corresponding section of chapter 6 on the Netherlands by analysing the (likely) position of the European Court of Human Rights (ECtHR) on the issue whether public entities such as municipalities or private undertakings controlled by them should enjoy the protection of the fundamental right to property. As private undertakings controlled by municipalities hold the energy distribution networks in the Netherlands, and are now prevented by legislation from selling these networks, the interpretation of Article 295 EC as rendered in Part 1 chapter 3 will also become relevant in section VI of chapter 6 when the compliance of further unilateral unbundling measures with EC law is discussed.

Finally, in chapter 7 of Part 2, the European Union comes back into the picture after the fundamental rights protection in the context of further unbundling legislation in the Member States Germany, Great Britain and the Netherlands has been discussed. Here, the fundamental rights issues arising in the context of the further unbundling legislation as initially proposed by the European Commission in September 20007 will be discussed (section II) against the background of the protection afforded on an EU level, which also takes the Charter of Fundamental Rights of the European Union (ECFR) into account as the EU institutions have submitted themselves to this catalogue of fundamental rights. Of particular interest are three issues: first whether public undertakings (are likely to) enjoy fundamental rights protection, secondly the enforcement practice of the European Court of Justice with respect to the proportionality of legislative measures, and thirdly the fact that there appears to be unequal treatment of private and public undertakings as regards the unbundling requirements proposed.[102] Section III will then apply the framework of fundamental rights protection as set out in the previous section to the actual unbundling measures proposed by the Commission in its proposals of 19 September 2007.

The fundamental rights discussion in Part 2 ties in with the assessment of the proportionality of ownership unbundling as remedy in a competition law enforcement context in chapter 2 of Part 1. What needs to be appreciated, however, is that the proportionality test as a common theme of this Part 2 comes in another guise. It is no longer an issue of whether the ownership unbundling is a proportionate remedy but rather whether sector-specific legislation for

[102] See n. 20.

ownership unbundling passes the proportionality test. Whereas in the context of Part 1 chapter 2, the European Commission acts as executive in individual cases with a rather narrow discretion, here the Parliaments of the Member States and the European Union act as legislature with respect to the whole sector and a wide margin of appreciation. Whereas in Part 1 Chapter 2, structural remedies are reactive to existing abusive behaviour (if established), in Part 2 sector-specific legislation is preventive and to some extent prospective or anticipatory as regards the developments in the sector concerned. For the proportionality test in both Parts, it is also important to appreciate that further unbundling intervenes *ex post*, i.e. into existing structure and rights, and heavily relies on the economic rationale of economic energy supply sector regulation, which prominently features economic efficiency as a balancing factor.[103]

An important aspect to extract from the elaborations on the proportionality test as applied in the various jurisdictions and contexts is whether albeit similar in structure, the proportionality test is also enforced in a similar fashion as regards, for instance, the margin of appreciation afforded to the acting institutions and the actual balancing of the various interests to be taken into consideration in order to afford effective fundamental rights protection. As regards the actual balancing of various interests in the context of the protection of the right to property, the weighing of the general interest or the *Sozialbindung* of property[104], as it is called in Germany, will also require closer scrutiny. It needs to be determined whether economic regulation, which is typically regarded as mere regulation of the right to property (or the freedom of economic activity) in order to be accepted in the general interest by the subject of the right to property, is able to *legitimately* allow for the deprivation of the entire right to property[105], or in other words, to completely suppress the private interest for the benefit of the general interest.

From Part 2, this research leads over to the **Conclusions** where lessons from the analyses of the first two Parts are drawn in order to determine conclusions for the legitimacy and the prospects of energy supply sector regulation in the EU.

Section A recapitulates the findings as regards the EU competences with respect to imposing further unbundling (in particular ownership unbundling) on vertically integrated European energy supply undertakings in the area of EC competition law and EC sector-specific regulation. Section B compares the

103 Thus, the relevant considerations remain largely the same.

104 "*Sozialbindung* of property" approximately translates as the social obligation of property ownership or as the attachement of property to public welfare or as the duty of property to also serve the general interest (and not just the private interest) or the importance of property for social coherence.

105 The term "deprivation" is explained in Part 2.

evolution and current structure and regulation of the energy sectors in Germany, Great Britain and the Netherlands. Section C makes a comparison of the relevant constitutional laws in Germany, the United Kingdom, the Netherlands and the European Union with respect to fundamental rights protection (and its effectiveness) against further unbundling; the issue of the protection of public undertakings will feature prominently here. Section D concludes and offers some forward-looking remarks.

PART 1
ECONOMIC REGULATION

It is the aim of the first part of this research to uncover the rationale behind the economic regulation of energy supply networks in the EU (chapter 1), which lies the foundation for exploring in chapters 2 and 3 whether "full structural" or legal ownership unbundling (or divestiture) of energy supply networks can be accomplished in the EU by means of, respectively, general competition law enforcement and energy sector-specific regulation.

CHAPTER 1
RATIONALE BEHIND ECONOMIC REGULATION OF EC ENERGY SUPPLY NETWORKS

The rationale behind European energy network regulation can best be inferred from the relevant objectives of the EC Treaty and the relevant task and activities described therein. These objectives find their expression in the Lisbon Agenda, which introduces this work.

Article 2 EC sets out as the task of the European Community "to promote throughout the Community" the ultimate objective of "a harmonious, balanced and sustainable development of economic activities, […] sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment […]." This is to be achieved "by establishing a common market and an economic […] union and by implementing common policies or activities referred to in Articles 3 and 4 [EC]"; the establishment of a common market is an interim goal and is an essential element of the Community's mission as set out at the beginning of this paragraph.[106]

The Lisbon Agenda of March 2000[107] ambitiously adds to this in terms of timing and furthering the objectives set out in Article 2 EC by envisaging the European Union becoming "[within the next decade] the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion."

The most important cornerstones today[108] (for the establishment) of a common market are market integration[109] with a view to creating an internal market[110] which reflects the fundamental freedoms (free movement of goods, persons,

106 Von Bogdandy in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. I, Article 2 EGV.
107 See Introduction, n. 1 and accompanying text.
108 Apart from the customs union as set out in Article 23 EC.
109 Originally purely economic, market integration today also includes non-economic elements as is reflected in some of the common activities set out in Article 3 EC, see in greater detail, von Bogdandy in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. I, Article 3 EGV.
110 Articles 3(c) and 14 EC.

services and capital) guaranteed by the EC Treaty, and the implementation of a system of competition ensuring that competition in the internal market is not distorted.[111] It can thus be said that the common market objective connects the fundamental freedoms of the EC Treaty and its competition rules.[112] Or, to put it differently, it is the competition law rules' objective to safeguard the internal market. The enforcement of competition law and the fundamental freedoms of the EC Treaty as integration tools thus belong to the constituting principles of the economic order of the EU.

Accordingly, the European Council when announcing the Lisbon Agenda calls for "stepping up the process of […] completing the internal market". It considers it essential to apply fair and uniform competition so that businesses can thrive and operate effectively on a level playing field in the internal market. The European Council thus wants "to speed up liberalisation in areas such as gas [and] electricity to achieve a fully operational internal market in these areas."

I. COMPETITIVE INTERNAL ENERGY SUPPLY MARKETS

The major objectives behind the competition law rules, i.e. competition policy, in the EU[113] are to increase consumer welfare and to ensure an efficient allocation of resources[114], and to promote the development of competition and market integration within the EU by affording every market participant a level playing field[115], i.e. the same initial opportunities, which can also be translated into

111 Article 3(g) EC.

112 In this vein, see ECJ, C-202/88 – *Frankreich* v *Commission*, (1999) ECR I-1223, 1269, no. 41. This connection can also be regarded as interdependency, i.e. competition in the common market can only function if there is a functioning internal market where the fundamental freedoms are guaranteed; *vice versa*, the internal market can only function and with it the fundamental freedoms if the competitive process in the common market is functioning.

113 Motta, n. 54, pp 17 *et seq*., for other policy objectives such as defending smaller firms and fighting inflation.

114 Consumer welfare as a goal of the competition policy of the EU is in contrast to the economists' view that the increase of economic welfare should be the goal, see Motta, n. 54, pp. 18–22; D Schmidtchen, 'Effizienz als Leitbild der Wettbewerbspolitik: Für einen "more economic approach"', German Working Papers in Law and Economics, Paper 3, 2005, pp. 39–40. See also J Basedow, 'Konsumentenwohlfahrt und Effizienz – Neue Leitbilder der Wettbewerbspolitik?', in his presentation at the 13. Internationale Kartellkonference in München on 27 March 2007 who sets consumer welfare as competition policy goal of the EU in contrast to the traditional German view that competition as such should be protected. See further, J Brodley, 'The economic goals of Antitrust: efficiency, consumer welfare, and technological progress', (1987) New York University Law Review 1020.

115 See B Baarsma, M de Nooij, W Koster, C van der Weijden, 'Divide and rule – The economic and legal implications of the proposed ownership unbundling of distribution and supply companies in the Dutch electricity sector', (2007) Energy Policy 1785.

safeguarding fair and equitable or non-discriminatory behaviour by all market participants.[116]

These objectives are to be achieved by economic regulation[117], which consists of general competition law enforcement and sector-specific regulation.

Sector-specific regulation fulfils in the context of competition policy and in particular with respect to formerly state regulated industries, the function of liberalizing or opening the corresponding market for competition and promoting competition in the relevant market place.

As part of economic regulation more generally, sector-specific regulation also fulfils the task complementary to and overlapping with the competition policy objectives, which is to promote the internal market by implementing and safeguarding the fundamental freedoms of the EC Treaty.

In industries, which consist of a monopolistic (*infra*structure) core, such as energy supply and telecommunication services, a further tool of sector-specific regulation (which is again complementary to the objectives of competition policy), is the pursuance of non-economic objectives to achieve additional politically desirable goals or public policy considerations, such as social and environmental goals.[118]

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116 Motta, n. 54, p. 26, is, however, sceptical as regards levelling the playing field when it means the safeguarding of equal outcomes of market competition, because it would harm investment and innovation, and, in general, the more successful market participant. Similarly, some major objectives set out here might potentially conflict with others, such as ensuring the efficient allocation of resources on the one hand and equitable behaviour on the other.

117 P Larouche, 'A Closer Look at Some Assumptions Underlying EC Regulation of Electronic Communications', (2002) Journal of Network Industries 129; de Bijl/van Damme/Larouche, n. 54, p. 4.

118 Often to the detriment of the competitive process. EC sector-specific regulation deals with a number of issues common to network-bound sectors such as telecommunications and energy, which seem to require continuing regulation, even when these sectors otherwise work competitively: licensing, pricing and transparency, access and interconnection, public service obligations, universal service and convergence. As to the latter, see P Slot, A Skudder, 'Common Features of Community Law Regulation in the Network-Bound Sectors', (2001) CML Rev. 87, and Larouche, n. 117.
Convergence means that the same service can be carried out over any transmission network, for instance in the case of electronic communications services over fixed or mobile, telecommunications or cable TV, satellite or terrestrial. Convergence is increasingly becoming an issue in the energy markets as well. Technology has allowed large industrial customers to demand coverage of their "energy" requirements rather than constraining them to the exclusive use of either gas or electricity. Although this mainly concerns diversified energy resources, it has got some implications for its transport as well as the ability to switch from gas networks to electricity networks and *vice versa*.

The various objectives of sector-specific regulation are also complemented by the imposition of public service obligations on providers of general (economic) interest[119], a category to which energy supply undertakings belong; in the specific energy supply related context, the relevant considerations include energy supply security[120] and reliability[121], which are both economic and non-economic in nature.

The parallel existence of competition policy, internal market, non-economic and public policy objectives for sector-specific regulation is complemented by overarching policy goals concerning all economic activities in the EU such as consumer protection.[122]

Public Service Obligations and Universal Service is specifically referred to in Articles 3 of the 2003 Energy Directives. Public Service Obligations (PSO) refer to specific requirements imposed on the providers of services of general interest to ensure that certain public interest objectives such as public security issues (such as technical energy supply security, security of energy supply etc.) and environmental protection are met. "Services of general interest" derives from "services of general economic interest" (SGEI), which is used in the EC Treaty, and is broader as it covers both market and non-market services which are classed as being of general interest and subject to specific public service obligations. Community legislation on services of general economic interest, although being sector-specific, contains a number of common elements that can be drawn on to define a Community concept of services of general economic interest including in particular universal service.

The concept of universal service refers to a set of general interest requirements ensuring that certain services are made available at a specified quality to all consumers and users throughout the territory of a Member State and at an affordable price. It has been developed specifically for some of the network industries (e.g. telecommunications, energy, rail transport, and postal services). The concept establishes the right for every citizen to access certain services considered as essential and imposes obligations (USO) on industries to provide a defined service at specified conditions, including complete territorial coverage.

See European Commission, Green Paper on Services of General Interest, COM(2003) 270 final, Brussels, 21.5.2003, pp. 7, 16, 35. For telecommunication, see P Larouche, 'Telecommunications', in D Geradin (ed.), *The Liberalization of State Monopolies in the European Union and Beyond*, 2000, p. 42; A de Streel, 'The Protection of the European Citizen in a Competitive E-Society: the New E.U. Universal Service Directive', (2003) Journal of Network Industries 189. For energy, see also L Hancher, 'Revising the European Community Internal Energy Market', in P Vass (ed.), *The Development of Energy Regulation – A Collection of Reviews*, May 2003, chapter 11, pp. 218 *et seq*.

119 See also n. 118.

120 Energy supply security in this context means secure availability of energy in terms of primary energy sources and electricity generation.

121 As the energy supply sector is network-bound, energy supply reliability in the context given means reliable energy transportation to the customer via energy transportation networks in terms of sufficient capacity and technical maintenance. The Commission seems to make no distinction between energy supply security and reliability, subsuming both investment in *infra*structure and in generation under security of supply, see Communication from the Commission, 'An Energy Policy for Europe', n. 6.

122 See R Whish, *Competition Law*, 5th ed. 2003, p. 18.

1. SECURE AND RELIABLE ENERGY SUPPLY MARKETS: THE INVESTMENT ISSUE

Of great importance in the context of the economic regulation of EC energy supply, and more specifically of the energy networks, is a particular component of the internal market rationale[123], and this is the objective of establishing and maintaining secure and reliable energy supply markets. For a functioning internal market in which the trading of network-bound energy can take place anywhere in the European Union, the national energy networks above all require sufficient network interconnection capacity for an internal market energy network to evolve as well as sufficient energy network capacity. Sufficient network and interconnection capacity is also a necessary prerequisite for competition to flourish in the internal market, and for energy supply security, i.e. sufficiently available energy throughout the EU[124], as well as for energy supply reliability, i.e. easing or even avoiding network constraints.[125] In particular electricity network interconnection often also serves as a substitute (or competitor) for electricity generation.[126]

More energy transportation *infra*structure investment as a necessary prerequisite for a competitively working internal energy supply market as one of the foundations of the (EC) economy, in which energy supply is secure and reliable, naturally requires investment by network owners, operators controlling the networks they operate or (potential) third party network investors. The task of European economic regulation, which comprises of competition law enforcement and sector-specific regulation, is to regulate energy networks in a way which promotes such investment.

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123 Which, complementary and overlapping with the competition policy objective, is to establish and promote the internal market by way of enforcing and safeguarding the fundamental freedoms of the EC Treaty.

124 As regards sufficiently available energy throughout the EU, it also seems (at least) equally important that sufficient generation capacity is available.

125 The German sector-specific regulatory agency Bundesnetzagentur (BNetzA), 'Monitoringbericht 2007', 29 June 2007, however, notes that the impact of foreign generation capacity on competition is, at least for Germany, which belongs to one of the largest energy supply markets in the European Union, rather small because electricity transport over long distances also entails losses in quantities transported. Pielow/Brunekreeft/Ehlers, n. 22, p. 5 (note 25), point out that increased interconnector capacity in order to enhance competition in the internal market changes electricity flows and increases the trade of electricity, which is likely to increase the pressure on the electricity networks, which might prejudice network reliability.

126 See only Balmert/Brunekreeft/Gabriel, n. 47. The NorNed cable might serve as an example; it connects the electricity transmission networks of the Netherlands and Norway, which at daytime feeds electricity produced by Norwegian water storages into the Dutch grid whereas excess electricity produced in the Netherlands at night helps pumping the water back into the Norwegian water storages. In greater detail, van der Lippe/Meijer, n. 44.

2. COMPETITIVE ENERGY SUPPLY: COMPETITION WHERE POSSIBLE, REGULATION WHERE NECESSARY

As indicated above, the energy supply industry is a network industry, which is based around the natural monopolies of energy transportation network *infra*structures[127], which in turn are often still part vertically integrated energy supply undertakings. The network *infra*structures are an indispensable or essential input for energy supply undertakings active in the related (potentially) competitive energy supply markets up- and downstream (i.e. gas production, electricity generation and energy retail) to enter and operate in those markets. Consequently, competitive energy supply depends on the non-discriminatory behaviour of the controllers of this monopolistic core of the energy supply chain[128], in particular in the case of those energy supply undertakings, which do not own energy transportation networks. It seems that there is a "systemic conflict of interest inherent in the vertical integration of supply and network activities"[129], which is perceived as one of the main obstacles to the competitive functioning of energy supply. This conflict is said not only to entail the risk of vertically integrated energy supply undertakings to prefer each other (i.e. members of their own group) when it comes to energy network access but also to result in a lack of willingness to invest in energy network *infra*structure for fear of increased competition on the related up- and downstream markets.[130]

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127 Normally also monopolistic bottlenecks, in electricity in general as well as in gas distribution; for gas transmission, see Knieps, n. 54.

128 Which, for technical and legal (mostly environmental and licensing) reasons, will continue to be the case for the time being, in contrast to, for instance the telecommunications sector where technological progress is on its way to enabling telecommunication services to find alternative routes (by technical means such as Voice over IP (VoIP), television cable, radio spectrum and mobile telephony) to customers thereby taking traditional physical means to transmit these services, such as the local loop (or, as often referred to, the last meter to the customer), their natural monopoly character away. See P de Bijl, 'Structural Separation and Access in Telecommunications Markets', TILEC Discussion Paper DP 2004–011, Tilburg University, 2004. See also the quotation from Slot/Skudder, n. 118 , in n. 143 *infra*.

129 See n. 3, nos 52 and 53. For the plausibility of this principal claim, see Pollitt, n. 37, and Mulder/Shestalova/Lijesen, n. 37 (in particular in the context of network industries).

130 This argument is also called strategic investment withholding, see Brunekreeft in his Discussion Paper, n. 9. The underlying assumption is that in a given electricity supply area with constraints on the interconnector to the outside, there is an incumbent vertically integrated energy supply undertaking. Expanding the interconnector would increase the import capacity into the supply area and would thus allow third parties to supply electricity in this area, which would increase competition with the incumbent. Therefore, because of its interest in protecting its position in generation, the vertically integrated incumbent would have inadequate incentives to expand the interconnection. An unbundled network operator, on the other hand, would not have an incentive to protect a generation business and would thus render the necessary investment into the network it is operating. However, the "strategic investment withholding" argument is limited. First, much depends on whether the vertically integrated incumbent is long or short in generation in relation to retail. If it is short of

Against this background, the Commission seeks to impose regulatory obligations in circumstances where the development of competitive markets is at risk, which is generally the case in network industries in transition from a non-competitive to a liberalized competitive structure. Accordingly, regulatory obligations should be imposed where effective competition and national and Community competition law remedies are not sufficient to address the problem: "[i]n markets where there continues to be large differences in negotiating power between undertakings, and where some undertakings rely on *infra*structure provided by others for delivery of their services, it is appropriate to establish a [regulatory] framework to ensure that the market functions effectively."[131] Thus, with respect to ensuring functioning competitive markets, obligations imposed by (national) regulatory authorities are supposed to be limited to those areas where remedies available under competition law cannot achieve the same results in the same time-scale.[132]

generation in relation to electricity retail to customers, then the incumbent is likely to have an interest to increase interconnector capacity in order to be able to purchase electricity. Secondly, a vertically integrated incumbent with excess generation capacity and low variable costs will want to export electricity for which it needs interconnector capacity. Thirdly, given that interconnector capacity can lead to more imports or to more exports, if interconnector capacity is used for more exports, competition is likely to increase globally, but inside the supply area (considered in isolation) competition is likely to decrease (because of sufficient generation there and/or lack of imports). Lastly, even if the strategic investment withholding argument holds in theory, in practice there are other investment limitations, which are likely to be more severe: Finding a suitable location and obtaining permission to build new interconnection capacity (or network capacity in general) faces many obstacles to overcome, not least because the resistance of the local population. See, in greater detail, Brunekreeft, *ibid*.

131 See, for instance, Recital 6 of Directive 2002/19/EC of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), OJ 2002 L 108/7, 24.4.2002, on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive). Note at this early stage that this is about effective but not necessarily *efficient* competition and functioning of the markets.

132 Mainly because of their ex post application, see further *infra*, n. 144 and accompanying text. However, as regards the time-scale issue, it should be appreciated that both the application of competition law and of sector-specific regulation can be time-consuming, at least with respect to its enforcement as the enforcement decisions in both cases are normally subject to time-consuming judicial review. This is only different in cases such as unbundling, which if introduced by sector-specific legislation is usually done by way of legal instruments, which are only indirectly reviewable, i.e. in cases where a regulator's decision is related to such unbundling.

II. COMPETITION LAW ENFORCEMENT AND SECTOR-SPECIFIC REGULATION: SCOPE AND EFFECT

As just indicated, the European Commission believes that only the restructuring of the energy supply industry by way of further unbundling, in particular ownership unbundling of the energy transmission networks, would remove the inherent incentive for vertically integrated energy supply undertakings to discriminate against competitors up- and downstream as regards network access[133], promote necessary investment in particular into energy transmission network and interconnection capacity (but also in generation) in a non-discriminatory way and make energy supply more transparent.[134]

Against this background, and after the outline of the rationale behind European economic regulation, and more specifically energy network regulation, it is now worthwhile to see how the energy networks can be regulated, i.e. to distinguish scope and effect of competition law enforcement and of sector-specific regulation in this regard[135], in order to appreciate whether competitive internal energy supply markets can only be achieved, as the European Commission claims, by restructuring the European energy industry.

For the purposes of this work, a distinction is drawn between the application of competition law *ex post* (following allegedly anti-competitive occurrences) and sector-specific regulation *ex ante* (before any evidence of anti-competitive behaviour and/or in order to prevent events[136] considered detrimental to the competitive process and/or in order to promote the development of the

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133 Third Party Access (TPA) is already comprehensively regulated, see in greater detail Part 1 Chapter 3.

134 See n. 6 and Recital 7 of the proposed Electricity Directive, n. 15. The Commission claims that "[e]conomic evidence shows that ownership unbundling is the most effective means to […] encourage investment." In this regard, see n. 3, no. 55. See also Pollitt, n. 37.

135 For general elaborations on the distinction between European competition law and regulation, in particular in network industries, see J Temple Lang, 'Competition Policy and Regulation: Differences, Overlaps, and Constraints', presentation at conference 'Balancing Antitrust and Regulation in Network Industries: Evolving Approaches in Europe and United States', Paris, January 2006.

136 Such as cross-subsidization, which in itself seems never to be illegitimate; only practices such as margin squeezing (explained *infra*), which may feature cross-subsidization, are anti-competitive and thus illegal, see in more detail, Willems/Ehlers, n. 2, with further references. Cross-subsidization is thought to be detrimental to the development of competition in markets such as the energy supply markets, which were previously run by established incumbents and closed to competition. The fact that incumbents were able to build up their dominance (in potentially competitive market segments) and (network *infra*structure) monopolies puts them – at the outset of liberalization – in an advantageous position. Thus, it is said that legitimate cross-subsidies would "harm" the "level playing field" for new market

competitive process).[137] *Ex ante* regulatory intervention would thus address market imperfections, which are thought either to exist already or likely to happen on the basis of a more abstract, theoretical analysis.[138]

In addition to distinguishing these two bodies of law according to the timing of their application, it is important to distinguish them with respect to their constitutional foundation and their application to the economy.

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entrants; they would also prevent incumbents from operating efficiently under competitive conditions. For a sceptical view, see Willems/Ehlers, *ibid.*

137 It should be stressed, however, that EC competition law is not generally just an *ex post* framework; a number of significant decisions are taken on an *ex ante* basis, such as clearances under the Merger Regulation. Apart from promoting security of energy supply (briefly explained in section I 1 *supra*) by sector-specific regulation, which is set out in chapter 3 section II *infra*, supply security can also be promoted by competition law enforcement in individual cases, which will not be elaborated on further in this work. An example for *ex ante* competition law enforcement in a merger setting is the merger between E.ON of Germany and MOL of Hungary, which was approved by the Commission after extensive merger remedies (by way of undertakings) had been conceded by the merging companies, see only van der Woude, n. 43, pp. 16–7, such as voluntary ownership unbundling of gas transmission *infra*structure, gas wholesale and gas storage activities in Hungary and a gas release programme in order to enhance liquidity (availability) of gas in the market for the benefit of competition in this area. Security of supply issues also play a role in *ex post* competition law enforcement such as when long-term contracts up- and downstream, see n. 43, or (network) capacity hoarding are targeted. As regards the long-term contract issues, see also van der Woude, *ibid.*, pp. 10–1, and G Kühne, 'Long-term Gas Contacts in Germany: An Assessment of the German Competition Authority', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports III*, 2006, chapter 4.
Decisions which would be qualified as *ex ante* are actually taken on the basis of historical data on the sector and *ex post* decisions often have *ex ante* elements. Even the "purest" *ex post* competition law case, where a firm is under scrutiny for past behaviour with documented effects on a well-known relevant market, will often involve some *ex ante* aspects in the remedies, which are meant to prevent future recurrences of anti-competitive behaviour. Further, competition law decisions under Article 81 and 82 EC (especially where interim relief is involved) actually fall between *ex ante* and *ex post*, in that the market is known, the allegedly anti-competitive behaviour is known, but its actual effects on competition are not fully known, since the intervention aims to prevent these effects from occurring. In the end, the distinction is best understood as a matter of degree: *ex ante* intervention takes place on the basis of a larger number of analytical assumptions and extrapolations than *ex post* intervention, which is based on a more solid evidentiary basis. See in greater detail, Larouche, n. 117.

138 *Ex ante* sector-specific regulation can also have *ex post* effects as was and would be the case with the unbundling prescribed by the 2003 Energy Directives and envisaged by the draft Energy Directives, n. 33, respectively. This is because unbundling in whatever form interferes with the structure of the undertakings active in the energy supply sector and thus the sector itself, which affects the undertakings and the sector *ex post*. As the focus of this work is on unbundling as a structural measure envisaged for the energy sector, only such *ex post* intervention will therefore be looked into, either on the basis of competition law enforcement or sector-specific regulation.

In the European Union, the EC Treaty has provided a peculiar structure of economic regulation, which enables two bodies of law, i.e. general competition law and sector-specific regulation to co-exist.[139] Whereas EC competition law as primary EC law applies to all economic sectors in the EU, sector specific regulation based on secondary EC law adopted by Community institutions on the basis of Treaty provisions is either directly applicable or implemented by the Member States into the national legal order (such as EC Regulations and Directives, respectively) and applies to a specific sector only.[140] Consequently, sector-specific regulation (and case law of the Community courts) cannot exclude the application of EC competition law.[141]

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139 The reason why in the EU competition law and sector specific regulation are not regarded as incompatible may also be due to the fact that network-bound services such as energy supply and telecommunication were originally carried out by direct public-sector provision, which did not require sector-specific regulation. The conflict was then not so much a collision between a stand-alone regulatory scheme and competition law but rather between public-sector undertakings and competition law. However, public sector undertakings were often exempted from the application of competition law, see also n. 136, as was for instance the case in Germany for energy supply under (repealed) s. 103 of the Law against competition restraints (Gesetz gegen Wettbewerbsbeschränkungen – GWB) and protected by so-called demarcated energy supply areas, in which mostly municipal or regional energy supply undertakings enjoyed sole supplier status, i.e. a local monopoly, see also *infra* n. 654 and accompanying text. S. 103 GWB was dropped in 1998 in the Gesetz gegen Wettbewerbsbeschränkungen (Law against competition restraints) of 26 August 1998 (revised version (*Neufassung*) published on 15 July 2005, BGBl. I, p. 2114). The application of competition law to such undertakings is reflected in Article 86 EC. As liberalization, which is in part motivated by economic and competition policy, replaces direct State intervention (in the form of direct provision of services (of general economic interest) such as energy supply) with sector-specific regulation, it does not appear unusual that competition law continues to apply to the so liberalized sector even in the presence of sector specific regulation. See further P Larouche, 'Contrasting legal solutions and the comparability of EU and US experiences', TILEC Discussion Paper DP 2006–028, Tilburg University, November 2006.

140 *Cf.* Larouche nn. 117, 139. As to the institutional setting, see further *infra* in this subsection. National sector-specific regulation induced the European Commission to increase their efforts to harmonize the national regulatory systems for network-bound sectors. An important issue in this context are the responsibilities within a Member State as regards the execution of sector-specific regulation. When considering the extent and application of sector-specific regulation as opposed to general competition law in network-bound sectors such as energy supply, the nature of such sectors has historically created diverse constitutional, administrative and institutional frameworks and systems with considerable government intervention, which is further complicated by the often very active involvement of *Länder* and provinces (as in Germany and the Netherlands) as well as other regional authorities and municipalities (as in Germany), which has also repercussions on the unbundling of these sectors. This involvement has resulted in public service obligations varying in different Member States. Such obligations are largely left at the discretion of the Member States, ECJ, C-280/00 – *Altmark Trans*, (2003) ECR I-7747. It has also often resulted in the holding of shares in the undertakings active in such sectors as well as the creation of "golden shares" meant to protect national industries (including in the area of energy supply) from hostile takeovers; the issue of "golden shares" is further discussed *infra* in the context of Article 56 EC.

141 Apart from the narrow exception of Article 86(2) EC, which concerns undertakings entrusted with "services of general economic interest" (see n. 118; the EC agricultural sector also allows

On the other hand, as the EC Treaty does not exclude the existence of sector specific regulation, such regulation must be designed in a way to avoid conflicts with the provisions of the EC Treaty. The Treaty thus employs harmonization mechanisms such as Article 95 EC in order to make national sector-specific regulation compliant to the EC Treaty, whose predominant goal is, as has been shown above, the creation of a competitive internal market.

In the context of EC energy supply market regulation, this was done by way of Directives and Regulations[142], which were based on EC Treaty provisions concerning the internal market – in the case of the internal market Directives on Articles 47(2) (right of establishment), 55 (services) EC and on Article 95 EC (harmonization of national legislation with a view to realizing the internal market), and in the case of the Regulations, on Article 95 EC. The value which harmonized sector-specific regulation adds in a European context is its application to all participants in a particular economic sector, whereas EC competition law only applies in individual cases.

A further distinction in this context is the fact that competition law relies on a small number of general provisions, such as Articles 81 and 82 EC, applied to protect the competitive process as the means to achieve the competition policy goals set out in section I above, whereas sector-specific regulation consists of a more specific set of legislative provisions (which are usually greater in number than the provisions of competition law), detailing the rules of the competitive game in the sector concerned.

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for certain exceptions, see Article 36 EC), the key provisions EC competition law, Article 81 and 82 EC, cannot simply be ignored by the Community institutions. The ECJ has never allowed any economic sector, in particular not a regulated one, to obtain a complete exemption from the application of EC competition law, neither has the Council nor the Commission. See Larouche, n. 139, p. 10 and notes 44, 45 there. This contrasts the U.S. Supreme Court's decision in re *Trinko*, *Verizon Communications* v *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), where the Court takes the view that where "a regulatory structure designed to deter and remedy competition harm exists," there will only be little scope for competition law intervention. The Court holds that where a regulatory structure has been established to remedy the risks of competitive harm, the additional benefits from competition law enforcement are likely to be limited. The background to this decision is the fact that Trinko's competition law based suit followed the local (telecommunication) exchange carrier Verizon's agreeing to implement several regulatory remedies to cure its anticompetitive behaviour, which led the Court to comment on the relationship between competition law and sector-specific regulation. For a discussion of this case, see N Petit, 'Circumscribing the Scope of EC Competition Law in Network Industries? A Comparative Approach to the US Supreme Court Ruling in the *Trinko* Case', (2004) Journal of Network Industries 347, 353.

142 See in greater detail, Part 1 Chapter 3 *infra*.

Detailing what has been outlined above, the primary task of sector specific regulation is to accompany the sector in its transition from monopoly to competition, i.e. to introduce, create and promote competition – essentially through market growth and the decline of the incumbent. Once this is accomplished, i.e. competition has taken hold on the market, it is generally accepted that regulation should be rolled back and general competition law should become the only body of law governing such market. On the other hand, in network-bound industries such as energy supply, which is compelled to rely on physical networks with natural monopoly characteristics, general competition law on its own is unlikely to suffice to safeguard the competitive structure of the energy markets.[143] This is so because competition law can only work where competitive forces can flourish on their own with competition law remedying individual anti-competitive behaviour, i.e. by resurrecting and maintaining competition up- and downstream from the viewpoint of the energy networks. Energy networks, however, as the indispensable link between the up- and downstream energy supply markets, require permanent supervision, at least as long as they remain natural monopolies.[144] Thus, in such circumstances sector-

143 See thus the "call" of the Commission for sector-specific regulation to step in should competition law enforcement tools on their own not suffice to sufficiently remedy an allegedly anti-competitive situation. Slot/Skudder, n. 118, argue that "whilst the incumbents hold a dominant position, either individual or collective, competition law possess the tools to deal with behavioural issues such as refusal of access, predatory or excessive pricing (see chapter 2 *infra*). However, as the policy of liberalization reaches its ultimate goal and these incumbents become merely market players like any other, and fall outside the realm of Article 82 EC, traditional competition law is left with very little power to deal with the problems inherent in a network reliant industry as Article 81 requires collusion between two or more undertakings. Where, for example, a single operator retains ownership of the network *infra*structure but access and interconnection regulation has reduced its market position to one of less than dominance, [...] [this] would suggest that the removal of such regulatory measures would be inappropriate as conventional competition would not suffice. Such a problem, however, may be dissipated in a situation where duplication of the base *infra*structure is economically viable (such as in the mobile telecommunications market or the market for the telecommunications fibre optic local loop)." This view is, however, difficult to comprehend, at least in the case of energy supply. Given that, in contrast to the telecommunications sector, technological progress in energy transport *infra*structure is slow and investment in parallel *infra*structure is prohibitively uneconomical, the owner and/or operator of energy networks will always retain a dominant position and, thus, Article 82 EC will continue to remain applicable. This is, as will be seen in section B *infra*, a situation, in which the criteria established by the ECJ in *Bronner* (C-7/97 – *Oscar Bronner* v *Mediaset*, (1998) ECR I-7791) find their natural application.

144 N. 128. Or, in other words, because of high and persistent barriers to entry, behind which effective competition is unlikely to develop and where the application of competition law alone does not appear to provide a solution. See P Larouche, 'Coordination of European and Member State Regulatory Policy – Horizontal, Vertical and Transversal Aspects', presentation at conference "Which Regulatory Authorities in Europe?", Brussels, 18 and 19 March 2004, mimeo, p. 11.

specific regulation will have to stay to supervise non-discriminatory and transparent access to the sector's network *infra*structures.[145]

But sector-specific regulation might also have to stay in order to safeguard non-economic objectives. In case of energy supply, this is so because it is not only an economic sector but also and increasingly indispensable for the proper functioning of the economy as a whole and of society. Functioning well as an economic sector lies within the domain of competition law, certainly in the longer-term, but safeguarding its societal function and foundation for the proper working of the economy as a whole might very well exceed the possibilities offered by a general regulatory framework such as competition law.[146] This becomes apparent when recognizing the non-economic objectives accompanying sector-specific regulation, such as universal service and public service obligations.[147]

Accordingly, the more energy supply works competitively, the more its regulation can be reduced to deal with a few specific economic characteristics of network-bound sectors in order to achieve the economic and non-economic objectives outlined before.

Two of these specific characteristics stand out, the first being the natural monopoly character of energy networks, and the second being network effects[148] of energy supply, which can occur at a number of levels. First of all, in the case of a new entrant to the energy supply market, network effects can prevent a supplier from competing on the strength of its offerings. As with the networks, this phenomenon requires regulatory supervision because competition law tools only apply in individual cases. Secondly, network effects can result in certain customers being deprived of access to energy supply because of a distortion between the creation of value for all users (by, for example, reinforcing the energy

145 Contra to the Commission's assumption, comprehensive regulation similar to the one applied in the current vertically integrated setting of the energy supply sector is likely to be required after a possible ownership unbundling of the energy supply networks, see in greater detail chapter 2 *infra*. In economic sectors, which are not network-bound or dependent on natural monopolies, i.e. even in areas with legal monopolies such as in the postal services sector, regulation is intended to last only as long as market imperfections or technical issues require it, and should ideally only be a transitional regime.

146 *Cf.* Larouche, n. 117, p. 141.

147 Public service obligations sometimes also pursue economic objectives such as energy supply security, see already n. 118. Security of energy supply also is a *conditio sine qua non* for the competitiveness of the European economy.

148 Basically meaning that the value to consumers of purchasing a service increases with the number of other customers, see M Cave, 'An Economic Analysis of Remedies in Network Industries', in D Geradin (ed.), *Remedies in Network Industries: EC Competition Law vs. Sector-specific Regulation*, 2004, pp. 1–19, and Whish, n. 122, p. 9.

network) and the recovery of costs from the additional customer to be connected. Here, the regulation of universal service provision receives its economic justification.[149] Thirdly, the absence of network effects at the transactional level due to problems of interconnection can have a negative impact on the performance of energy supply as a foundation for society and from a European perspective impede energy supply throughout the EU. What can already be indicated here is that transactional problems are likely to become more prevalent as the energy supply sector becomes more fragmented in the light of increased competition.

In furtherance of the general outline of the objectives of energy sector-specific regulation in section I above, the main objectives of EC energy sector-specific regulation, which mainly relates to the regulation of the energy networks[150], can be described as[151]:

- To create and develop competition in an imperfect competitive situation characterized by natural energy network monopolies in order to facilitate market entry, by promoting competition of networks[152] or at least competition of services up- and downstream in an internal market, which depend on the use of such networks.
- To ensure that all energy suppliers have equal access to any network *infra*structure indispensable to their activities and that customers have equal access to any energy supplier, both groups on standardised terms and conditions for network access.
- To prevent the exploitation of (natural) monopoly power, in particular by way of access price regulation, which ensures efficiency gains and the promotion

149 Similar Larouche, n. 117, p. 143, for the telecommunications sectors. It can generally be said that a competitive energy market would fail to supply energy to customers in uneconomical locations or with limited incomes. Thus, some form of regulatory intervention will always be needed to ensure that at least a minimum set of services, of a specified quality and affordable price are made available to all users, irrespective of location or profitability. The notions of affordability (and general availability) and quality are open to wide interpretation, which may lead to discrepancies between Member States and a consequent distortion of the playing field between operators or energy suppliers, which may be subject to more onerous obligations in one country than in another and thereby put some at a competitive disadvantage, see Slot/Skudder, n. 118.

150 And for the achievement of which unbundling instruments such as accounts, functional, operational and legal unbundling, are considered necessary instruments, see in greater detail chapter 3 *infra*.

151 See, for instance, Recitals 1, 3, 4, 5, 7, 14, 22, 24 of the proposed Electricity Directive, n. 15.

152 Which because of the natural energy network monopolies is not realistic apart from in situations such as gas transmission where alternative networks exist, see Knieps, n. 54, or in the case of interconnectors, which compete with generation, see Balmert/Brunekreeft/Gabriel, n. 47.

of network investment (for energy reliability or interconnection purposes)[153], and to make access conditions transparent and non-discriminatory.[154]

– To restructure the energy supply sector in order to provide for the commercial independence of energy network operations from the up- and downstream businesses of vertically integrated energy supply undertakings[155] (to safeguard or achieve the previously stated objectives and prevent cross-subsidization).[156]
– To ensure that any imperfections in the market do not cause harm to consumers (to achieve which entails the provision of the universal service obligation)[157] and requiring market participants in general and network operators in particular to meet objective and non-discriminatory quality and safety standards, and to require a fair, non-discriminatory and transparent licensing regime.[158]

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153 Investment in generation and thus energy supply security (as defined here, see section I(1)) remains in the remit of national energy sector-specific regulation (see, however, also chapter 3 section II *infra*), which is mainly concerned with creating the right financial and structural incentives; the latter include preferred location and connection to the networks.

154 In terms of applying similar tariffs to similar transactions.

155 To date, the restructuring has reached a status where vertically integrated energy supply undertakings must have implemented accounts unbundling and be operationally and legally unbundled, see Introduction.

156 On cross-subsidization see already n. 136. Accounts and legal unbundling as a result of current sector-specific regulation, which makes cost-accounting transparent, already makes cross-subsidization detectable. Moreover, the Dutch competition authority NMa (Nederlandse Mededingingsautoriteit) made it clear in May 2007 that even in a setting where energy supply undertakings are legally unbundled with the network operators not owning the network they operate (so-called lean or slim network operators), regulation is able to effectively prevent cross-subsidization from taking place, see NMa, 'Onderzoeksrapport inzake de interne verrekenprijzen van energiebedrijven', no. 102363 / 94 (report rendered in the context of *Onderzoek Winst Energiebedrijven* (no. 102362)), 2 May 2007, in particular p. 6.

157 See nn. 118 and 147 and accompanying text.

158 Given the politically sensitive nature of licensing or authorising operations (not to mention planning procedures and dealing with environmental concerns), which are partly due to different legal traditions, Member States have retained control over the quality of market participants, which leaves them with considerable discretion in this respect; only minimum requirements are prescribed, if any, such as, for instance, for natural gas *infra*structure in Article 4 of Gas Directive 2003. As regards energy network operations, this discretion, however, leads to different licensing procedures and requirements in place in the Member States, which are potentially hampering the development of an internal market for energy and causing competitive disadvantages throughout the Community as well as retarding the development of cross-border interconnectors. In the UK, for example, the licence is the backbone of the regulatory process throughout the energy supply chain. These licences impose extensive and detailed obligations upon the licensee, incorporating everything from public service obligations to specified quality standards and price controls. By contrast, the systems adopted in the Netherlands and in Germany are much less comprehensive and intrusive, which only require permission to operate energy transport (transmission and distribution) networks).

It follows from these objectives that, more generally, sector-specific regulation deals with market imperfections and controls market power, as is both the case in the network-bound energy supply industry where energy supply undertakings have to rely on energy networks (provided by others). As a result, it usually controls market access and market behaviour, and deals with technical issues. It may alter the existing situation in and structure of the market (as do mergers and merger remedies).[159] Regulation can provide certainty in advance (if only given enough time to take effect), which facilitates or even abolishes negotiations between the parties involved. Regulators may need to strengthen the effectiveness of both competition law and regulatory rules by imposing detailed obligations for both *infra*structure and services, such as, for instance cost accounting obligations in order to make cross-subsidization visible.

On the other hand, EC competition law has evolved such that it complements regulation on major regulatory issues, such as introducing a European style "essential facilities doctrine" in order to enable access to so-called essential facilities such as network *infra*structures[160], and broadening the non-discrimination principle to cover preferential treatment of intra-firm dealings compared to dealings with competitors also, for instance, in the area of network access, and greater attention to pricing issues such as price squeezes and excessive pricing.[161] An example of the latter has become apparent, for instance, in the *Deutsche Telekom* case discussed in the next section, which discusses competitive concerns in the context of the vertically integrated operation of energy networks where it seems that the competition law function of sector-specific regulation failed to work properly.

On the institutional side[162], there is a further distinction between sector-specific regulation and competition law enforcement in that national regulatory

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159 In this respect, see also L Hancher, R de Vlam, 'Mergers in the Electricity Sector – Relevant Markets and Related Issues', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports I*, 2004, Part 1 Chapter 3, B Eberlein, 'Regulation by cooperation: the 'third way' in making rules for the internal energy market', in P Cameron, (ed.), *Legal Aspects of EU Energy Regulation – Implementing the New Directives on Electricity and Gas across Europe*, OUP, 2005, ch. 4, and *infra* at nn. 169, 177 and accompanying text.

160 See in more detail Part 1 Chapter 2 section II *infra*.

161 See Larouche, n. 49, pp. 230, 231 *et seq*. The majority opinion in the U.S. case in re *Trinko*, see n. 141, also appears to accept the application of competition law in addition to regulation when it admits that where regulation exists its degree of completeness could in fact influence the interpretation of competition law, which could in a different factual setting lead to a situation where competition law might apply on top of regulation. See Larouche, n. 139, pp. 8, 9.

162 The first obvious difference between European competition law and regulation on the institutional side is that only until recently, European competition law has been enforced primarily by the Commission, and since the entering-into-force of Regulation (EC) No 1/2003

authorities can normally take action in situations where competition authorities usually have no power to act. This is so because

- first, regulation creates or involves the power to create and impose new legal duties, for the purposes for which the regulation was adopted and for which regulators have been given a direct and specific mandate by the legislature.[163] Regulation usually has aims, which are wider than those of competition law, and has methods which go beyond those of competition law, because regulators can (within the constraints of the legislation on which they are acting) impose whatever additional or new duties are thought necessary to promote the objectives specified. Because regulators can impose new or additional obligations, they can impose very precise obligations. A competition authority on the other hand usually has no power to impose new duties but only applies and executes general competition law.[164]
- secondly, regulators can act *ex ante*, i.e. before companies behave in a certain way. Competition authorities normally enforce existing rules on market participants. Competition law gives power only to stop already identifiable illegal actions, while regulation gives power to alter an existing situation which is entirely legal, to promote regulatory objectives, which is the case, for instance, for unbundling and the prevention of cross-subsidies. When, for instance, the question arises whether access should be given to an *infra*structure facility, which is said to be indispensable to all market participants, a regulator, if empowered to do so under legislation, may impose a duty to give access, and determine the precise terms of access. A competition authority, on the contrary must determine whether all the conditions for ordering access under competition law are fulfilled[165], and then determine the terms of access, usually on a non-discriminatory basis. Competition authorities are also able, however, to determine the precise terms of access in a situation where sector-specific regulatory experience exists, which can generally be said to be the case in energy supply markets, and where both

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of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty ("Modernization Regulation" or "Regulation 1/20003"), OJ 2003 L 1/1, 4.1.2003, by national competition authorities. European regulatory policies within the framework of European Directives, to the contrary, have always and only been carried out by national authorities, which are obliged according to Article 10 EC to facilitate the achievement of the Community's tasks and to abstain from any measure, which could jeopardise the attainment of the objectives of the Treaty.

163 Regulatory authorities nevertheless have to obey the rules contained in the EC Treaty, in particular those on competition law. By contrast, the mandate of competition law is very general and its execution thus follows an adjudicative process.

164 In order to impose precise conditions of access (see also Part 1 Chapter 2 *infra* at the discussion of the so-called essential facilities doctrine), the competition authority normally employs non-discrimination obligations to make the conditions precise.

165 See Part 1 Chapter 2 *infra* for a comprehensive discussion of this question.

institutions, the regulatory authority and the competition authority, cooperate.[166] In a dispute about alleged anti-competitive behaviour, which involves cross-subsidization[167], a competition authority must usually decide on the basis of the cost accounting information available.[168] A regulator can impose precise cost accounting requirements, and impose an estimated access price on a provisional basis until all relevant data is available.

Besides the differences between competition law and regulation, it has already been indicated above that their objectives overlap[169], and a clear distinction as to their application is sometimes hard to draw, in particular when regulators and competition authorities are active in the same sector.[170] For example, the recently established German *Bundesnetzagentur* (BNetzA), which is responsible for regulating energy networks crossing more than one German state, has partly assumed control over network access issues from the German Competition

166 See *infra* nn. 170 and 175 and accompanying text.

167 See Part 1 Chapter 2 *infra* for more details on this question.

168 A competition authority can, however, also employ an external expert as a so-called monitoring trustee, which monitors the compliance of the undertaking concerned with the remedies imposed, see, for instaonly, CFI, T-201/04 – *Microsoft v Commission*, (2007) ECR II-3601, nos 1251–1279, where, however, the condition for such an installation and the extent of powers conferred upon such a trustee were declared excessive because, amongst other reasons, they were deemed to exceed the powers the Commission can legitimately exercise itself. To what extent the undertaking on which such a monitoring trustee is imposed also has to bear the cost of such an appointment (including the remuneration of the trustee) was also subject to controversy, which might thus have to already be considered when determining adequate remedies or setting fines. Depending on which form of cooperation is customary between the competition authority and the sector-specific regulator, the Commission or national competition authority might also be able to instruct the regulatory authority to supervise the proper implementation of commitments entered into by the parties as a condition for the approval of their merger (in merger control proceedings) or for closing competition cases in competition proceedings based on Article 82 EC. With respect to such commitments, see Article 9 Regulation 1/2003. For an example of such a practice in the Italian telecommunications services sector, see Larouche, n. 144, pp. 17–8.

169 General competition law and sector-specific regulation might blur in merger cases where competition authorities might endeavour to restructure a certain market, thereby taking on a typical task of a (sector-specific) regulatory agency. See in this regard, Motta, n. 54, p. xviii (n. 2); Hancher/de Vlam, n. 159; Larouche, n. 139, p. 13 with further references.

170 Primary EC law already ensures that regulators whose competencies are based either on secondary EC legislation such as Directives and/or on national law work together with the national competition authorities (NCAs) since regulators (NRAs) must avoid contradicting or undermining the primacy of EC competition law. Compliance with EC law is, however, not just about implementing secondary sector-specific legislation such as Directives but also ensuring the effectiveness (*effet utile*) of EC (competition) law, a principle, which is not only central to ECJ case law (see only ECJ, C-26/62 – *Van Gend & Loos*, (1963) ECR I-12) but which also flows directly from primary EC law such as Article 10 EC. Usually, the Member States have implemented this through some sort of cooperation agreement between NRAs and NCAs, which typically assigns common cases to one of these authorities – usually the NRA, with rules to refer cases from one authority to the other accordingly. When dealing with such a case, the handling authority must consult with the other. See Larouche, n. 144, p. 14.

Authority (*Bundeskartellamt* – BKartA). Accordingly, the provisions of the German Energy Industry Act (EnWG)[171] relating to network connection and access[172] take precedence[173] over the national competition law provisions against abuses of a dominant position.[174] The BKartA, however, is still responsible for the application of Article 82 EC, which might lead to its taking action against an energy network owner abusing its dominant position and ordering access according to Article 82 EC.[175]

In any event, what can be concluded is that the cooperation of NRAs and NCAs in regulated network-bound sector such as the energy supply sector, which is assumed to be comprehensively regulated, results in a division of labour as well as an exchange of expertise and information[176] when drafting solutions or remedies to a competition and regulatory issue, in particular during the preparation of such a decision where the opinion and input of the other authority is required.

Competition authorities, on the other hand, sometimes act in a regulatory manner when exercising their competition powers. The European Commission, for instance, acts in such a manner when it goes beyond what seems to be strictly

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171 Gesetz über die Elektrizitäts- und Gasversorgung (Energiewirtschaftsgesetz (Energy Industry Act) – EnWG) of 7 July 2005, BGBl. I, p. 1970 (3671).

172 Part III of the EnWG.

173 S. 111 EnWG, s. 130(3) GWB.

174 Ss 19 and 20 GWB.

175 See also Article 3 Regulation 1/2003 as regards the application of Article 82 EC by national competition authorities. Conflicts are thought to be avoided through a coordination mechanism in s. 58 EnWG. As regards the potential inherent in institutional situations like this to *forum shopping*, see N Petit, 'The Proliferation of National Regulatory Authorities alongside Competition Authorities: A Source of Jurisdictional Confusion', GCLC Working Paper 02/04. For alternative cooperation solutions and their inherent conflict potentials in the Netherlands (DTe as energy regulator is a special subdivision of the competition authority NMa) and the UK (OFGEM as sector regulator has concurrent powers to the competition authority OFT in the area of competition law), see the corresponding chapters *infra*. See also Larouche, n. 144, p. 16, discussing questions of principle in relation to cooperation within such models.

176 Competition authorities, for instance, can use their investigative powers to gather market data and conduct the substantive assessment, whereas NRAs are better able to work out and implement remedies for market deficiencies. In the case of the energy sector inquiry, see n. 3, the Commission went even further in also taking on the (regulator's) role of working out the remedies, in that the Directorate General of Competition (DG COMP) under the lead of Commissioner Kroes conducted the investigation, which lead to the conclusion that there were serious competition law issues in the energy supply sector but closing the inquiry without any immediate enforcement action. The Directorate General responsible for energy issues (DG TREN) under the lead of Commissioner Piebalgs then drafted the proposals of 19 September 2007, which are described in the Introduction, which contain as one major remedy to the perceived malfunction of the energy supply markets the unbundling of vertically integrated energy supply undertakings. For the telecommunication services sector, Larouche, n. 144, p. 17.

necessary to resolve competition issues by using the merger clearance regime as a means to impose quasi-regulation on the energy sector via merger remedies.[177]

This "regulatory" attitude also becomes obvious in cases where the Commission enforces competition law even though regulatory authorities did not intervene where they could (should) have. In its 1998 Notice on Access Agreements[178], the Commission clarifies that "[g]iven the detailed nature of ONP rules [sector-specific regulation of telecommunication services] and the fact that they may go beyond the requirements of Article 86 [now Article 82 EC], undertakings operating in the telecommunications sector should be aware that compliance with the Community competition rules does not absolve them of their duty to abide by obligations imposed in the ONP [i.e. regulatory] context and *vice versa*."[179] As *Larouche*[180] puts it, the statement "vice versa", which the Commission applied in its decision in *Deutsche Telekom* (discussed in the next subsection), "typically illustrates how the Commission emphasizes either the convergence or the differences between competition law and regulation, depending on what serves its purpose", which basically means that the Commission is taking advantage of its position as EC competition authority for regulatory purposes, which, it is submitted, is problematic[181] to say the least because regulation is a primarily legislative task (of the EU legislature), which is to be implemented by the Member States and enforced by national regulatory agencies.

Based on the observations made in this section, such institutional behaviour raises doubts as regards its legitimacy given the rather different legislative mandate competition law enforcement agencies and regulators have in the EU, and given that the Commission as competition law authority is supposed to act, on the one hand, as a guardian of EU wide competition and market integration only, and on the other hand as an initiator of sector-specific regulation but not as

177 It seems that the purpose of remedies has generally been to develop competition not just to restore it. See Hancher/de Vlam, n. 159, pp. 68–9. See also Eberlein, n. 159, p. 79, speaking of merger control as a "regulatory lever to promote domestic market opening and regulatory change." In re *Marathon* (COMP/36.246), press releases IP/04/573 of 30 April 2006, IP/03/1129 of 29 July 2003, IP/03/547 of 16 April 2003, IP/01/164 of 23 November 2001, the Commission has actually set up an access regime, which appears to be regulatory in character, *cf.* van der Woude, n. 43, p. 12.

178 Notice on the application of the competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles, OJ 1998 C 265/2, 22.8.1998, no. 22.

179 Emphasis added.

180 Larouche, n. 139, pp. 9, 10.

181 See Hancher/de Vlam, n. 177, and Ehlers, n. 7.

the actual regulator.[182] Whether this attitude of the Commission might now also extend to the application of Article 82 EC in cases of individual energy supply undertakings abusing their dominant position, and in particular with respect to the regulatory endeavours of Competition Commissioner Kroes to restructure the energy "marketplace" by way of unbundling the ownership of energy networks, will be subject of chapter 2. It has become clear in the ongoing EU energy policy debate that the Commission, and in particular Commissioner Kroes, holds the firm opinion that ownership unbundling of the energy transmission networks is the only solution to the systemic conflict within vertically integrated energy supply undertakings and the strategic investment withholding argument.

III. COMPETITION CONCERNS INVOLVING CONTROL OF ENERGY NETWORKS

In order to appreciate the potential necessity of *ex post* competition law enforcement in the market for access to vertically integrated energy networks, it is useful to recall what kind of competition concerns can arise from controlling such *infra*structures.

As has been outline above, firms active in the upstream and/or downstream energy supply market, which do not own energy networks to feed in to and/or out of, need access to energy networks to supply their customers. Unless the terms of access are imposed by law, this dependency forces such firms into contractual relationships with the network operator, in which they are inevitably in a weaker bargaining position as they normally do not have the choice of alternative networks because of the natural monopoly characteristic of energy networks. This, by the way, is true no matter whether energy network operators are vertically integrated or independent. Because they operate a natural monopoly, network operators are, naturally, dominant undertakings so that Article 82 EC applies in the case of conduct which constitutes abuse[183]; they control access from upstream and to downstream energy supply markets.

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182 The Commission, however, already "steers" the NRAs by way of guidelines, which become legally binding after passing the so-called comitology procedure, see n. 460 and, in greater detail, chapter 3 section III, in particular nn. 461 *et seq.* and accompanying text.

183 Knieps, n. 54, as regards monopolistic bottlenecks; only these are supposed to be dominant.

The following types of abuses, in which firms controlling the operation of energy networks may become involved, can be broadly categorized:

One category of abuses are those which purport to protect and expand the (dominant) position of vertically integrated energy supply undertakings up- and downstream in order to exclude competitors from those markets.[184] Such abuses are called exclusionary practices such as refusal to supply (also called refusal to deal), discrimination in the form of price or margin squeezes (as a special variant of predatory pricing) and exclusive dealing (here in the form of capacity reservation contracts).[185] Such abuses are often facilitated by or connected to the strategic withholding of investment into energy transportation *infra*structure.[186]

The other category of abuses is directed at customers up- and downstream in order to reap the benefits of dominance by exploiting them. They are called exploitative practices. Excessive pricing and other unfair trading conditions are typical examples.[187]

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184 The former incumbent vertically integrated energy supply undertakings, which still control energy networks and their operation, are usually still dominant in "their" former often legally protected service areas.

185 Capacity reservations by vertically integrated undertakings are not caught by Article 81 EC because the agreements are not concluded between undertakings, see Kjølbye, 'Vertical Agreements', in C Jones (ed.), *EU Energy Law – Volume II: EU Competition Law & Energy Markets*, 2nd ed., 2007, Part 3 Chapter 3 no. 3.304, who refers to the application of the "essential facilities doctrine" and Article 82 EC in this context. This will be discussed in chapter 2.

186 Brunekreeft, n. 9. In its final report of 10 January 2007 on the sector inquiry concluded between June and November 2005, n. 3, the Commission identified the following practices, some of which might be caught by Article 82 EC (only such practices relevant as potential abuses in the context of (vertically integrated) energy network operations are mentioned; "RTS" means that these practices are potentially a refusal to supply access to energy networks in a wider sense, see *infra*, "SIW" means strategic investment withholding, which causes congestion (scarce capacity) on energy networks and thus might lead to refusal of supply situations): discriminatory network access conditions (RTS), postponement of (necessary) network investments (SIW), both leading to vertical foreclosure [but see also the danger of vertical foreclosure resulting from the integration of generation and retail, see Thomas, n. 331, and accompanying text], insufficient interconnecting *infra*structure controlled by incumbents and investment therein (SIW), which together with insufficient congestion management (RTS) hinder market integration, and insufficient data on network capacity and asymmetrical access to such data. Also, the procurement of balancing capacity can be discriminatory (RTS).

187 It should be emphasized that dominance profits are a natural feature of dominance, and since dominance in itself is acknowledged but not prohibited under EC law, it is claimed that denigrating prices leading to such profits as excessive or unfair would be a negation of the very concept of dominance, see van der Woude, 'Article 82 EC – Abuse of a dominant position', in C Jones (ed.), *EU Energy Law – Volume II: EU Competition Law & Energy Markets*, 2005, Part 3 Chapter 4 no. 3.229, a concept, which already requires dominant undertakings to maintain the competitive process, an obligation, which curtails substantially their commercial freedom. What has to be borne in mind in this context is that as firms controlling energy network operations are per se dominant, they automatically assume a special responsibility

However, this distinction is not clear cut as, for instance, excessive prices charged by a vertically integrated energy network operator to competitors of its related downstream energy supply business normally have the same effect as denying access to the network, i.e. an outright refusal to deal, thus excluding competitors from competing on the downstream energy supply market.[188]

As already indicated, the only concerns dealt with here are those which can directly involve vertically integrated firms controlling the operation of energy networks (essential *infra*structures without which access from upstream and to downstream markets is not possible), and it is only such concerns, which the European Commission considers worth targeting with the structural remedy of ownership unbundling.[189] This means that the main focus here will be on situations of refusal to supply or, in other words, direct and indirect or disguised (meaning conduct which has a similar, vertically foreclosing effect as a) refusal to grant access to energy networks, which would fall foul of Article 82 EC[190]; the latter kind of refusal also includes unequal access conditions.[191] The other abuses

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under European law and jurisprudence as regards their behaviour in the markets they are active in. Article 82 is a direct reflection of this special responsibility of dominant firms in that commercial practices pursued by those firms are at times classified as abusive where the same practices would not be so in the absence of market power. See also n. 202, and van der Woude, *ibid*., no. 3.206.

188 Van der Woude, *ibid*., no. 3.201.

189 See final report on sector inquiry, n. 3. See also van der Woude, 'Article 82 EC – Abuse of a dominant position', in C Jones (ed.), *EU Energy Law – Volume II: EU Competition Law & Energy Markets*, 2nd ed., 2007, Part 3 Chapter 4 no. 3.428.

190 See also van der Woude, n. 187, as regards relationship between Articles 81 and 82 EC.

191 Unequal access conditions are actually more often observed than straight forward refusals to supply. The sector inquiry report observes vertically integrated network operators granting priority access to affiliated undertakings (no. 168 of the report) or delaying network connections to the detriment of new entrants (no. 493). They may also charge prices or demand payment conditions that differ from the terms applied to affiliated undertakings (no. 196), which are, however, normally prevented by *ex ante* tariff regulation. Services offered by network operators to third party undertakings appear less advantageous than those offered to affiliates, which includes data for customers willing to switch suppliers and discriminatory procurement of balancing (generation) capacity by transmissions system operators (TSOs) which offer affiliated generators a secure outlet (no. 156), which is one example of vertical foreclosure [for vertical foreclosure resulting from the integration of generation and retail, see Thomas, n. 331, and accompanying text] of upstream competitors wanting to feed generated electricity into the electricity networks. Further, a lack of transparent access conditions is generally complained about (no. 510), in particular with regard to network capacity; the lack of transparency is aggravated by the fact that vertically integrated undertakings possess a systemic information advantage. The report finally observes that integrated network operators appear not to have the same incentives to invest in additional transport capacity as non-integrated operators. With respect to the last aspect, see, however, Brunekreeft, n. 9, with respect to the argument of strategic investment withholding and its shortcomings, and The Brattle Group, 'Independent System Operator for EU Energy Markets', Current Topics in Energy Markets & Regulations, Issue 01, 2007, p. 3, with respect to the danger of overinvestment by non-integrated ISOs.

mentioned below, i.e. exclusive dealing and discrimination in the form of price squeezing, can occur separately but usually arise in the context of refusal of supply situations.

The following types of abusive behaviour can thus be said to be the usual suspects in the context of vertically integrated energy network operation and the most relevant to this work:

– *refusal to deal*, here in terms of supply, which is elaborated in more detail in chapter 2. In the context of a network operator granting access to the network it operates, a refusal to supply the access required means that this creates a barrier for competitors in a related up- or downstream market to entry to or exit from that market[192], consequently weakening or eliminating competition in that market.[193] Such a refusal does not necessarily mean outright denial of

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192 In the context of natural monopolies or monopolistic bottlenecks, see n. 54, access to such facilities must be indispensable for providing complementary goods and services *upstream* or *downstream* in the supply chain. See Knieps, n. 54, p. 174, Motta, n. 54, p. 66. In re *Sea Containers* v *Stena Sealink*, n. 50, the Commission states in no. 66 that "[a]n undertaking in a dominant position may not discriminate in favour of its own activities in a *related* market. The owner of an essential facility which uses its power in one market in order to protect or strengthen its position in *another related* market, in particular, by refusing to grant access to a competitor, or by granting access on less favourable terms than those of its own services, and thus imposing a competitive disadvantage on its competitors, infringes Article 86 (now Article 82 EC) (emphasis added)."

193 The Commission has not yet rendered official decisions on access refusals in the energy sector. When analysing the Commission Decision (2004/33/EC) of 27 August 2003 (Case COMP/37.685 – *GVG/FS ("Georg")*), OJ 2004 L 11/17, 16.1.2004, which concerns access refusals in the Italian railway sector, it appears, however, that the Commission is likely to take a similar approach as the Dutch competition authority NMa in the *Sep* case (decision of 26 August 1999; case no. 650/Hydro Energy B.V. vs Sep), which fined SEP, the then incumbent electricity generator and operator of the Dutch transmission networks, in 1998 for refusing network access to Norsk Hydro, which wanted to import electricity into the Dutch market. See in greater detail, van der Woude, n. 189, nos 3.418 *et seq*. In another, energy related context, the Commission stated ('Role of interconnectors in the electricity market. A competition perspective', MEMO/01/76, 12 March 2001) that there was "an economic incentive for the Network Operator to discriminate in favour of the producer/supplier with which it is vertically integrated […]. The existence of this incentive creates a risk of discrimination actually taking place. *Such a situation is addressed by the EC competition rules* (emphasis added)." An important case with can be said to have value as a precedent for the energy sector is actually the *Marathon* case, n. 177, which will play an important role for the elaborations to follow. Marathon, a U.S. energy supply undertaking trying to enter the European gas supply market as newcomer, complained about pipeline access conditions. The settlement reached between the Commission and several energy supply undertakings of France, the Netherlands and Germany included arrangements for an increased transparency of access conditions; it was inter alia agreed to publish pipeline capacity on the undertakings' websites, to grant non-discriminatory access to storage facilities and to impose so-called "use-or-lose-it" obligations on affiliated trading businesses, meaning that unused pipeline capacity is made available in the market and not hoarded. Further, gas release programs were implemented, and the

access for a certain firm but can also take the form of charging excessive prices or imposing unreasonable trading conditions[194], which render it economically impossible to compete in related markets. In more general terms, there are mainly two reasons why a dominant firm would refuse to supply customers: either to protect its activities in the market it dominates[195] or, as is the case for vertically integrated energy network operators, to protect the potentially competitive position of affiliates in a related market.[196]

– *exclusive dealing*, which can take various forms, the most obvious of which in the current context are so-called (energy network) capacity reservation agreements by (usually incumbent) dominant energy supply undertakings with (usually vertically integrated) energy network operators.[197] The rationale behind such exclusive dealing agreements is to prevent competitors up- or downstream from entering the market, increasing their market shares or challenging the dominant firm's position in the relevant market. Such

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likelihood of implicit access refusals significantly reduced by improving the handling of access requests and eliminating response times through the introduction of online booking procedures. The undertakings also agreed to introduce entry and exit capacity reservations, which means that capacity need only be reserved at such points, and not, as previously, for each pipeline section along the contracted transport route, which can amount to having to contract with a large number of pipeline operators, depending on how many sections were operated by different operators.

194 Article 82(a) EC provides that imposing unfair purchasing or selling prices or other unfair trading conditions is prohibited. Because dominant undertakings are, according to the ECJ, able to behave to a considerable extent independently from external competitive pressure, customers and suppliers, such independence implies that the dominant undertaking is able to set prices as it sees fit. As Article 82 does not provide any criteria for determining the existence of such exploitation or unfair practices, in *United Brands*, C-27/76, (1978) ECR I-207, the ECJ used the economic value of the products or services in question as a criterion for defining prices as excessive (i.e. prices which have no reasonable relation to the economic value of the product supplied). The Court suggested that one criterion for the determination of the economic value of a product is not only to refer to the prices of competing products but also to the difference between the costs actually incurred by the dominant undertaking and the price actually charged.

195 In *United Brands*, *ibid*., the dominant firm terminated the supply of its long-standing distributor because it began selling bananas of a competitor of the dominant firm.

196 In *Commercial Solvents* (ECJ, C-6/73 – *ICI* & *Commercial Solvents* v *Commission*, (1974) ECR-223), the dominant firm terminated the supply of raw materials to one of its customers in order to compete with this customer in the downstream market for goods containing these materials. This was seen as the refusal to supply an essential input resulting in the leveraging of the dominant firm's monopoly in one market to the downstream market.

197 See, for instance, ECJ, C-17/03 – *VEMW, APX en Eneco N.V.* v *DTE*, (2005) ECR I-10805, discussed by L. Hancher, 'Case C-17/03, *VEMW, APX en Eneco N.v.* v. *DTE*', case note, (2006) Common Market Law Review (CML Rev.) 1125. For a more general outline of exclusive dealing obligations, also with respect to exclusive purchasing agreements in the context of protecting investments in new generation capacity and LTCs for gas supply, see van der Woude, n. 187, nos 3.202–4. See also ECJ, C-393/92 – *Almelo*, (1994) ECR I-1477, and European Commission, 'Commission closes investigation on Spanish company GAS NATURAL', IP/00/297, press release of 27.03.2000. See also Kühne, n. 137.

contracts are not only problematic with respect to their often long duration but even more, which is often the case, if reserved capacity is not used.[198] A wide-spread practice, this is a highly topical issue whose legitimacy is currently debated in the context of investments in cross-border interconnectors[199], either in the form of regulated interconnection when built by transmission network operators, or in the form of merchant transmission investment.[200]

– *discrimination and exclusionary pricing practices*: Article 82(c) EC prescribes that dominant firms are not allowed to discriminate between their customers if a different treatment causes these customers competitive harm in the market where they operate.[201] From this it follows that unjustified price discrimination by dominant firms is prohibited because of their special responsibility to safeguard a fair competitive process in related markets, which is based on the rationale that dominance, which in itself is already constraining competition, should not lead to a further constraint of competition.[202] One of the objectives of Article 82 EC therefore seems to be

198 This type of conduct also reduces output, which is covered by Article 82(b) EC, see van der Woude, n. 189, no. 3.399.

199 See also Talus/Wälde, n. 47. In 2001, the Commission forced the British and French transmission network operators owning the UK-French interconnector (see also Part 2 Chapter 5 on Great Britain), to amend its access regime. The French incumbent EDF lost its exclusive capacity reservation without any reservations made for anyone else, and it was ensured that there was fair access to the French transmission grid. Capacity of the interconnector is now allocated through auctions. The Commission held that reserving capacity in favour of certain companies was discriminatory and amounted to an abuse of the dominant position held by the two transmission network operators. See European Commission, 'UK-French electricity interconnector opens up, increasing scope for competition', IP/01/341, press release of 12 March 2001. Capacity allocated in so-called open season procedures (see nn. 290, 1331), auctions or else nowadays usually become subject to the so-called use-it-or-lose-it obligation, which means that unused or un-contracted capacity must be sold on the market under transparent and non-discriminatory conditions.

200 See G Brunekreeft, 'Marked-based investment in electricity transmission networks: controllable flow', (2004) Utilities Policy 269, and 'Regulatory issues in merchant transmission investment', (2005) Utilities Policy 175. See also Talus/Wälde, n. 47. For the issue of growing competition between electricity generation and transmission, see Pollitt, (2007) Intereconomics, n. 37, and Balmert/Brunekreeft/Gabriel, n. 47.

201 They are thus bound by an obligation of non-discrimination, which means that a dominant firm must treat third parties equally by way of offering similar terms and conditions. See ECJ, C-333/94 P – *Tetra Pak II* v *Commission*, (1996) ECR I-5951; Larouche, n. 49, pp. 218–230; de Bijl/van Damme/Larouche, n. 54, p. 6. But note that excessive pricing alone seems to have never been sufficient to hold an undertaking responsible under Article 82 EC. So far, only in *United Brands*, n. 194, has excessive pricing played a significant role. See also D Geradin, N Petit, 'Price Discrimination under EC Competition Law: The Need for a case-by-case Approach', GCLC Working Paper 07/05, College of Europe, and 'Price Discrimination under EC Competition Law: Another Antitrust Doctrine in Search of Limiting Principles?', TILEC Discussion Paper DP 2006–023, August 2006.

202 In the EU, market dominance of undertakings does not in itself contravene EC competition law; only in exceptional circumstances where public undertakings are involved such as in

> the protection of competition up- or downstream against potential repercussions stemming from a dominant position in a related market.[203]

The prohibition of discriminatory behaviour in order to protect competition in related markets becomes of particular importance if a firm controlling networks and thus being dominant in energy transportation is also present in such a related market because then the dominant firm has the incentive to grant its business there more favourable terms and condition than competing firms. In the case of price discrimination, should the price be a significant component of the costs of products offered in that related market, such discriminatory conduct could ultimately lead to the monopolization of that related market by driving existing competitors out of that market of by raising entry barriers prohibitively. Article 82 EC therefore requires dominant undertakings to deal with their operations in related markets at arm's length, which naturally poses a particular constraint on vertically integrated undertakings. Thus, vertically integrated energy network operators, which are "naturally" dominant in the market of energy transportation[204], have a duty to treat their affiliates in the upstream energy production or downstream energy supply markets at arm's length, i.e. to provide them with energy transportation on the same terms and conditions as those applied to equivalent non-integrated undertaking requesting access.[205]

ECJ, C-163/96 – *Silvano Raso,* (1998) ECR I-533, and C-320/91 – *Corbeau*, (1993) ECR I-2533, because of the structure of an undertaking, does dominance result in the abuse of such dominance as soon as such an undertaking acts in the market. This must be distinguished from vertically integrated undertakings based around a monopolistic core such as energy networks whose ownership of the networks creates an inherent or systemic risk of abuse of their dominant position in the market for access to these networks for the benefit of their up- and downstream businesses. Dominant undertakings, however, carry a special responsibility "not to allow [their] conduct to impair undistorted competition on the common market", see ECJ, C-322/81 – *Michelin* v *Commission*, (1983) ECR I-3461. See also van der Woude, n. 187. As a consequence, it can be said that Article 82 restricts the conduct of dominant undertakings in that a certain unilateral course of action might be permissible when committed by competitors but can be prohibited when committed by a dominant undertaking. According to the Court of First Instance (CFI), in specific circumstances, undertakings in a dominant position may be deprived of the right to adopt a course of conduct or to take measures, which are not in themselves abuses, see CFI, T-111/96 – *ITT Promedia* v *Commission*, (1998) ECR II-2937.

203 Van der Woude, n. 187, no. 3.216. See also Geradin/Petit, n. 201. Another issue arising in the context of discriminatory conduct of dominant undertakings is the way such firms can respond to aggressive price competition, i.e. where competitors offer, for instance, specific customers advantageous terms and conditions in order to poach them from the incumbent. In *Irish Sugar*, T-228/97, (1999) ECR II-2969, no. 189, the Court of First Instance (CFI) emphasized that "the protection of the commercial position of an undertaking in a dominant position […] must, […] in order to be lawful, be based on criteria of economic efficiency and consistent with the interests of consumers."

204 See n. 54 and accompanying text.

205 Van der Woude, n. 187, no. 3.216. Two other potentially discriminatory situations, in which dominant firms, and more particularly in the current context, independent energy network

In energy markets, conflicts regularly occur with regard to non-discriminatory access to (vertically integrated) energy network *infra*structure. Energy *infra*structure often is constrained in its capacity or congested, i.e. the physical energy network can only transport certain volumes or quantities of electricity or gas. These conflicts are exacerbated by (already mentioned) exclusive reservations of energy network capacity.[206]

Discriminatory pricing issues have rarely been dealt with in isolation by the Commission or the European Courts. It has usually been dealt with in the context of other allegedly abusive behaviour of dominant undertakings, often in the context of predatory pricing[207], which is the classic example of exclusionary pricing, or, more relevant in the context of network industries, a special variant of predatory pricing, the so-called price or margin squeeze, which raises the dominant (vertically integrated) undertaking's rival's cost.[208] In an energy network setting, a margin squeeze can occur if the vertically integrated energy supply undertaking is not only present on the energy transportation market

operators, such as in the UK privately held National Grid plc., in the Netherlands state-owned TenneT, the regulated interconnectors between the UK and the Netherlands and the Netherlands and Norway, and the Finnish-Baltic interconnector (see in greater detail *infra*, chapter 3 and Part 2 Chapters 5 and 6 on Great Birtain and the Netherlands) can find themselves are (i) price discrimination between non-competing customers on the one hand, which is in principle not forbidden by Article 82 EC (and which can, if at all, play a role with regard to geographical price discrimination where customers in different geographical locations have to pay different prices. Since the creation of a single market and market integration are the overarching objectives of the EU, conduct which divides existing markets, might under certain (but rare) circumstances be caught by Article 82 EC. The only price discrimination case decided so far by the ECJ is in *United Brands*, n. 194, where it was ruled that a dominant undertaking should not exploit differences in geographical markets in that they may not unjustifiedly charge different prices depending on what the different geographical markets can bear. See, critical in particular with regard to the *United Brands* case, van der Woude, n. 187, no. 3.217) and (ii) in times of scarce resources where a dominant firm is forced to allocate products between its customers.

206 See, for instance, ECJ, C-17/03, n. 197. See also the Commission Staff Working Document on the decision C-17/03 of 7 June 2005 of the Court of Justice of the European Communities, 'Preferential Access to Transport Networks under the Electricity and Gas Internal Market Directives', SEC(2006) 547, Brussels, 26.4.2006. See also nn. 459, 461, 462 and accompanying text with respect to the guidelines annexed to the 2003 Electricity and 2005 Gas Regulations, which deal with issues such as congestion management. Remedies for such reservations are so-called use-it-or-lose-it obligations (see also n. 199), which are also used in exemptions granted for new (merchant or regulated) transmission, (explicit or implicit) auctions and open-market coupling. As regards these remedies, see in greater detail chapter 3 *infra*.

207 See Willems/Ehlers, n. 2: Predatory pricing is the undercutting of the prices of competitors by offering prices, which are below costs. Such pricing policy only makes sense if the losses incurred are likely to be recovered at a later stage. This is the case if barriers to entry make renewed market entry of competitors driven out of the market as a result of predatory pricing unlikely, which is normally the case if market entry requires high sunk costs (van der Woude, n. 187, no. 3.221), such as building electricity generating plants.

208 See Willems/Ehlers, n. 2.

through its energy network operation but also on the downstream supply market where energy can only be supplied if received from the energy producer through the energy network input. Thus, the vertically integrated energy supply undertaking's rivals on the downstream market depend on the vertically integrated energy network operator for its input, i.e. the transporting of energy. Consequently, vertically integrated energy network operators may be inclined to charge competitors of their downstream energy supply business high energy transmission or distribution fees whilst the downstream business, which does not have to bear the same high level of charges, offers customers and end consumers low prices downstream. Its competitors, however, have to compete with such low prices whilst being forced to pay higher energy transportation charges. This situation obviously affects the profit margins that these competitors are able to achieve downstream. Therefore, this pricing behaviour is called price or margin squeeze.[209]

A good example to illustrate margin squeezing but also the relationship between competition law intervention and sector-specific regulation is the still contested decision of the European Commission in re *Deutsche Telekom* (DT)[210] where it seems that the competition law function of sector-specific regulation failed to work properly.

The Commission's decision concerned the prices charged by DT to its competitors and consumers between the end of 1998 and 2002 for access to its local loops in Germany. The local loop is the physical circuit between the consumer's premises and the telecommunications operator's local switch; competitors need access on adequate and non-discriminatory terms to the local loop in order to offer retail services to consumers and compete with the incumbent. In March 1999, several competitors claimed that the prices charged for competitors' access on the wholesale local loop market were higher than the prices charged to DT's own subscribers on the retail market. It was thus claimed that DT prevented competitors from competing in the retail local loop market and deterred new entrance into the market, thus squeezing the profit margin of DT's competitors because even if they are as efficient as the *infra*structure owner DT on the retail

209 See, in greater detail, G Brunekreeft, E van Damme, P Larouche, V Sorana, 'On the law and economics of price squeeze in telecommunications markets', TILEC Report, February 2005, and D Geradin and R O'Donoghue, 'The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector', GCLC Working Paper 04/05, College of Europe. See also the European Commission's Notice on the application of the competition rules to access agreements in the telecommunications sector, n. 178.

210 Commission Decision (2003/707/EC) of 23 May 2003 (Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom AG*), OJ 2003 L 263/9, 14.10.2003, confirmed by CFI, T-271/03 – *Deutsche Telekom* v *Commission*, 10 April 2008, not yet reported (appeal to ECJ, C-280/08, pending).

or downstream market, they would have to bear higher costs of access than the incumbent's own retail business. DT, however, argued that its wholesale local loop access tariffs had been approved by the German regulator, and that, therefore, the Commission was not entitled to step in against an undertaking whose charges were regulated at national level.[211] Instead, if a violation of EC law was found, the Commission should only be allowed to initiate infringement proceedings against Germany according to Article 226 EC. The Commission rejected DT's defence stating that "the competition rules may apply where the sector-specific legislation does not preclude the undertaking it governs from engaging in autonomous conduct that prevents, restricts or distorts competition."[212] Moreover, the Commission emphasized that despite regulation, DT retained a commercial discretion allowing it to restructure its tariffs in a way as to put an end to the price squeeze[213], for instance by either increasing its retail charges or by raising prices of other non-regulated charges. The Commission therefore found that DT's margin squeeze was an imposition of unfair selling prices within the meaning of Article 82(a) EC.[214] Against the background of what has been established in chapter 1 above, the Commission by applying Article 82 EC in the DT case despite the actions taken by the German regulator on the basis of German telecommunications law, which is largely based on EC Directives, and

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211 The German regulator seemed not to have resolved an obvious problem. It had approved wholesale unbundled local loop tariffs to be paid by DT's competitors downstream, which were higher than the equally regulated retail tariffs for monthly subscription to DT's network by end users.

212 Commission Decision, n. 210, no. 91.

213 Commission Decision, n. 210, no. 57. Thus assuming the special responsibility it holds as a dominant undertaking under Article 82 EC, which is not to disturb the competitive process.

214 DT was fined after taking the prior regulation into account, not as a justification of its behaviour but as a mitigating factor for the calculation of the fine, see Commission Decision, n. 210, no. 212. It has also been argued that the margin squeeze test used by the Commission was flawed, because, for instance, it artificially split the monthly subscription from the actual call charges, with the result that the German regulator might after all not have been mistaken. See in greater detail, Larouche, n. 139, p. 7. Larouche, *ibid*., p. 8, further argues that the Commission, instead of convicting DT, should have taken legal action against Germany. Given that the wholesale unbundled local loop tariffs were rightly regulated on a cost-orientated basis, the cause for the margin squeeze was obviously the retail tariffs, which were too low. The reason for the latter was that Germany had failed to carry out tariff rebalancing ahead of liberalization in 1998 thereby breaching its obligations under Commission Directive 90/388/EC of 28 June 1990 on competition in the markets for telecommunications services, OJ 1990 L 192/10, 24.7.1990. Accordingly, the Commission could have opened infringement proceedings under Article 226 EC against Germany for not having properly implemented secondary EC law. In practice, though, such infringement proceedings would have been rather ineffective as a remedy because in the case of a conviction, Germany would have had to initiate regulatory action to remove the margin squeeze, which would have been likely to take much longer than bringing a competition law action against DT forcing it to remedy the situation swiftly itself in order to avoid further litigation including possible damage claims by competitors.

albeit quasi-regulatory in nature, simply obeyed the superiority of EC competition law over sector-specific regulation.[215]

Coming back to predatory pricing, or more specifically, price squeezing, vertically integrated energy supply undertakings, which control energy networks and are thus dominant in the market for network access, can use the profits made with its network business to cross-subsidize the lower prices of their businesses in upstream energy wholesale markets or downstream energy supply markets, which are not abusive as long as they are not below incremental costs.[216] But cross-subsidies in themselves are not illegal according to Article 82 EC.[217] Thus, the eradication of cross-subsidies in the quest for a more "level playing field" for competitors not owning energy networks cannot be accomplished by competition law, at least not directly. Anticompetitive conduct such as predatory pricing or price squeezing, in which context cross-subsidies can also occur, can only be remedied in individual cases under competition law.

Cross-subsidies can thus only be controlled and prevented by unbundling measures such as accounts and/or legal unbundling and proper supervision by sector-specific regulatory authorities with a corresponding legislative mandate such as the 2003 Energy Directives.[218]

The competition concerns mentioned here are often parts of the direct or indirect refusal to supply network access to the energy networks, which is indispensable for upstream energy producers or wholesalers to fulfil contracts with energy suppliers and for downstream energy suppliers. Together with strategic investment withholding, they are particularly relevant in times of energy network

215 Irrespective of any more adequate course of action such as initiating proceedings against Germany according to Article 226 EC.

216 See in greater detail Willems/Ehlers, n. 2, with further references.

217 Cross-subsidies, which do not contravene Article 82 EC, may still be state aid and thus illegal according to Article 87 and 88 EC. See also L Hancher and J Buendia Sierra, 'Cross-Subsidization and EC Law', (1998) CML Rev. 901, and G Abbamonte, 'Cross-Subsidisation and Community Competition Rules: Efficient Pricing Versus Equity', (1998) E.L. Rev. 414, the first also with respect to the issue of state-aid. More generally on cross-subsidization in EC law, L Hancher, 'Cross Subsidization in EC Law', in L Hancher (ed.), *Competition and Security of Supply in the EC Energy Market*, 1995, pp. 113–130.

218 The Dutch competition authority NMa established in May 2007, n. 156, that it is indeed possible in the current regulatory setting of legally unbundled energy supply undertakings that cross-subsidies can be prevented from taking place. The 2003 Energy Directives explicitly seek to induce regulators to prevent cross-subsidization, see Willems/Ehlers, n. 2, with further references.

congestion, i.e. when capacity is scarce, an issue, which has climbed high on the political agenda in the context of interconnectors.[219]

[219] The reinvestment of profits deriving from so-called congestion charges into interconnection, for example is one explicit option for using these profits, see Regulation (EC) No 1228/2003 of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, OJ 2003 L 176/1, 15.7.2003. See also the references in n. 200. See in greater detail, chapter 3 *infra*.

CHAPTER 2
EC COMPETITION LAW ENFORCEMENT IN VERTICALLY INTEGRATED ENERGY NETWORK OPERATIONS

After outlining the rationale behind European energy network regulation, which consists of general competition law and energy supply sector regulation, and given the applicability in principle of EC competition law parallel to *ex ante* sector-specific regulation[220], it will now have to be established whether full structural unbundling or legal ownership unbundling (or divestiture) of energy transportation networks as envisaged by Competition Commissioner Kroes can be accomplished in the European Union by way of (general) competition law enforcement.

I. INTRODUCTION

On the assumption that as a result of the liberalization efforts of the European Union the behaviour and structure of the European energy supply sector as a

[220] The concurrent application of regulation and competition is prone to produce a conflict between the goal of competition law to protect consumer welfare and the aim of regulation to create or maintain equal opportunities ("level playing field") for firms when tey are reliant on competitors, which occupy a dominant position because they own essential inputs. Geradin/O'Donoghue, n. 209, p. 64, thus suggest that such a potential conflict can be resolved by applying Article 82 EC as primary EC law to take precedence over regulation. If, however, it is believed that consumer welfare can be increased in the long run by promoting entry of firms, which are less efficient than the dominant firm, regulation must be used to achieve this, not competition law.

typical network industry[221] is comprehensively regulated[222], the scope and need, if any, for the European Commission to mandate the structural remedy of legal ownership unbundling (in the form of forced divestiture) of energy networks (gas pipelines and electricity grids) from vertically integrated energy supply undertakings will be examined in turn. Based on Article 82 EC, such a structural remedy would be adopted in individual cases as a corrective competition law based measure *ex post*. The aim of such a measure would be to prevent vertically integrated energy network operators, which hold a naturally dominant position, from (abusively) foreclosing access by up- and downstream competitors of their affiliated up- or downstream businesses to the corresponding markets, which the Commission claims is done by unlawful (*de facto*) refusal to supply the energy network input (access to their networks), which is indispensable to operate on these markets[223], and by not investing into the development of the networks (strategic investment withholding).

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221 By following the definition of Cave, n. 148, p. 1, such networks exhibit one ore more of the following characteristics: (1) economies of scale, over a range of outputs substantial in relation to the demand as a whole; as demand is location specific, this often takes the particular form of an economy of density, (2) economies of scope, and/or (3) demand-side network effects, carrying the implication that the value to consumers of purchasing the service increases with the number of other customers. See also Mulder/Shestalova/Lijesen, n. 37. The traditional regulated industries, i.e. telecommunications, energy, rail services and water display these characteristics in various ways, see also Mulder/Shestalova/Lijesen, *ibid*. To call postal services a network industry seems problematic, see P de Bijl, E van Damme, P Larouche, 'Towards a liberalised postal market', TILEC Report, Tilburg University, August 2003. They all have, additionally, in common that they consist of a number of separable production processes. See also P Joskow, R Noll, 'The Bell Doctrine: Applications in Telecommunications, Electricity, and Other Network Industries', (1999) Stanford Law Review 1249.

222 Which does not say anything about whether the regulation is deficient in places. Comprehensive regulation in the context given does not only include the approval and supervision of (the methodology of) the energy network access (charges) terms and condition but also the unbundling of the energy supply industry *up to* and including legal unbundling, which means accounts, operational, functional and legal unbundling, see already *supra* in the Introduction. Accordingly, cross-subsidization as one issue (which is, however, not too important anymore, see NMa, n. 156, and Willems/Ehlers, n. 2) to consider in the (regulatory) establishment of a level playing field, see *supra* chapter 1, has become visible. The legitimacy of the unbundling measures already in place is not subject of this work; the existence of these unbundling measures plays a role in order to appreciate whether competition law based ownership unbundling is necessary; the existence of such unbundling measures is also of relevance *infra* where the legitimacy of further unbundling legislation is discussed.

223 Refusal of supply and what is perceived as such is discussed in chapter 1 section III. There will be no discussion of the *ex ante* or preventive merger control application of competition law (in this respect, see the EC Merger Regulation, n. 19), which would be applicable in the context of proposed mergers of energy supply undertakings. In merger control proceedings, the parties to a proposed merger can if so "requested" by the European Commission "voluntarily" commit to divesting parts of their businesses in order to obtain clearance of their merger plans; this is voluntary to the extent that the merging parties have a choice of either offering commitments such as divesting certain parts of their businesses in order to ease competition concerns or accepting that they might not be allowed to pursue with the merger envisaged.

Particular emphasis will be put on the remedial proportionality test and on the importance of economic efficiency as a factor to be considered in the application of this test (section II(1)). The circumstances in which the European Commission and the ECJ mandate network access in cases of refusal by energy network owners[224] to grant TPA on reasonable and non-discriminatory terms and in a timely manner, will be explored as part of the proportionality test in section II(2). Thereafter, the need for a detailed analysis of the costs and benefits of further unbundling will be considered when evaluating efficiency as an essential factor in determining the proportionality of a remedy (section II(3)). Section III concludes.

II. ARTICLE 82 EC AND REGULATION 1/2003: COMPETENCE TO ORDER STRUCTURAL REMEDIES

As just set out above, the Energy Directives are supposed to promote competition in the energy markets in the EU and to create an internal energy market.[225] Apart from sector-specific regulatory authorities enforcing and supervising the operation and access to the energy supply networks, the Directives currently seek to achieve their aims by prescribing structural separation of vertically integrated energy undertakings by way of legal (or corporate) unbundling[226] of the operation of monopolistic electricity and gas networks[227] from the potentially competing supply businesses (operating in related markets), which is an (ex post) intervention into the structure of established undertakings by way of regulation.[228] The motive behind such sector-wide unbundling is not any established abuse of a dominant position or any other violation of competition law but merely to promote

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For a merger, which contained substantial divestiture commitments, see the Commission Decision (2006/622/EC) of 21 December 2005 (Case COMP/M.3696 – *E.ON/MOL*), OJ 2006 L 253/20, 16.9.2006. On this merger, L Hancher, 'EU Law and Policy on Vertical and Conglomerate Energy Mergers', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports III*, Intersentia, Antwerpen, Oxford, 2006, chapter 3, 44 *et seq.* See also Hancher/de Vlam, n. 159, p. 69, with respect to the quasi-regulatory conduct of the European Commission in merger cases. In this regard, see also Ehlers, n. 7. The application of Article 81 EC with respect to, for instance, long-term energy (in particular gas) supply contracts will also not be part of the discussion which follows; in this regard, see, for instance, Kühne, n. 137.

224 Energy transportation networks as natural monopolies are commonly referred to as "essential" or "indispensable" facilities or monopolistic bottlenecks (when network capacity is scarce or congested).

225 *Cf.*, e.g., Recital 31 Electricity Directive 2003 and Recital 30 Gas Directive 2003.

226 Which means incorporating a separate legal entity situated within a common shareholding structure. See already section C.II.3 of the Introduction.

227 See n. 54.

228 See also text accompanying n. 49.

competition in an imperfect market setting, which is characterized by its monopolistic core.[229] As we have seen above, competition law in contrast is supposed not to create but to restore the competitive process, i.e. when anti-competitive behaviour has already occurred. It is against this background that Commissioner Kroes threatens to use her general competition law enforcement tools to impose full structural unbundling on individual vertically integrated energy supply undertakings.

Article 7 Modernization Regulation[230] empowers the European Commission to adopt (behavioural and) structural remedies by Decision in order to bring an infringement of Article 81 or Article 82 EC to an end.[231] According to the UK

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229 It should again be noted that the legitimacy of the current unbundling measures is not the subject of this work.

230 Article 7(1) of Regulation 1/2003 (n. 162) provides: 'Where the Commission, acting on a complaint or on its own initiative, finds that there is an infringement of Article 81 or of Article 82 of the Treaty, it may by decision require the undertakings and associations of undertakings concerned to bring such infringement to an end. For this purpose, it may impose on them any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Structural remedies can only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. If the Commission has a legitimate interest in doing so, it may also find that an infringement has been committed in the past." The interpretation of Article 7 can be found in Recital 12 Modernization Regulation, which states that the "[…] Regulation should make explicit provision for the Commission's power to impose any remedy, whether behavioural or structural, which is necessary to bring the infringement *effectively* to an end, *having regard to the principle of proportionality*. Structural remedies should only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. *Changes to the structure of an undertaking* as it existed before the infringement was committed *would only be proportionate where there is a substantial risk of a lasting or repeated infringement that derives from the very structure of the undertaking* (emphasis added)."

231 Here, only Article 82 will play a role focusing on abusive practices of dominant undertakings, which are prohibited as incompatible with the common market in so far as they may affect trade between Member States. For the distinction between Article 81 EC and Article 82 EC, see van der Woude, n. 187. With regard to abusive conduct, which "may affect trade between Member States", when a national court or competition authority decide on abusive conduct of dominant undertakings, they have to apply Article 82 and the Modernization Regulation or an equivalent national provision transposing Article 82 into national law. In the event that national provisions deviate from the correct interpretation of Article 82, Article 82 must be applied directly (direct effect of Treaty rules) and be given primacy (principle of primacy of Community law), and the deviating national provisions may complement the interpretation of Article 82 only if this complementary interpretation is in line with Community law and the aim of achieving a competitive internal market. For the interpretation of what "may affect trade", the Commission Notice, 'Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty', OJ 2004 C 101/81, 27.4.2004, can be used. These Guidelines, which give national authorities guidance on the interpretation of Community inter-state trade, leave only marginal room for the interpretation of abusive conduct *not* affecting inter-state trade (i.e. if the abuse is of purely local nature or involves only an insignificant share of

Office of Fair Trading, bringing such an infringement to an end may require directing (or accepting a binding commitment by) an undertaking to make structural changes to its business, which might involve withdrawing from a particular activity or even divesting itself of a part of its business.[232]

1. SELECTION OF REMEDY: LEGAL PROPORTIONALITY AND ECONOMIC EFFICIENCY

The choice of a – behavioural or structural[233] – remedy to end abusive behaviour of a dominant undertaking must obey the principle of proportionality.[234]

This principle is applicable under general international law as well as under the European Convention of Human Rights[235], which has been ratified by all the Member States of the European Union, and is thus of great influence to European law.[236] The principle of proportionality is also recognized as fundamental constitutional principle in most of the EU Member States' legal systems.[237] It is

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sales of the dominant undertaking). It is submitted that the concern voiced, e.g. by Hancher, n. 54, that the application of different sets of rules (i.e. Article 82 if inter-state trade is affected, and national rules which may deviate from Article 82 if not) should not be too great an obstacle to substantial harmonization of national competition laws, even though these Guidelines are in principle not of binding character.

232 Office of Fair Trading, 'Enforcement', Competition law 2004, December 2004, pp. 4, 12. A good example where the Commission accepted a commitment to a structural remedy [for the distinction between structural and behavioural or conduct remedies, see also A Klees, S Hauser, 'Eigentumsrechtliche Entflechtung in der Energiewirtschaft als strukturelle Maßnahme i.S.d. Article 7 Abs. 1 Satz 2 VO 1/2003?', (2007) WuW 596], albeit under the old rules (Regulation No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty, [1962] OJ 13/204, 21.2.1962) is the Commission Decision (2001/354/EC) of 20 March 2001 (Case COMP/35.141 – *Deutsche Post AG*), OJ 2001 L 125/27, 5.5.2001, where Deutsche Post undertook to transfer all its commercial parcel activities, including the catalogue delivery, to a legally separate company by December 2001.

233 Structural remedies address the incentives of the vertically integrated incumbent and behavioural remedies control or even eliminate its ability to restrict competition, i.e. to deny, delay or restrict network access. Further to this distinction, see Klees/Hauser, *ibid*. See also OECD, 'Restructuring Public Utilities for Competition', Policy Brief, Paris, February 2002, pp. 5, 9.

234 The principle of proportionality forms an integral part of each national, supranational or international legal system, which aspires to live up to the rule of law not only in form but also in substance, see E Pache, 'Der Grundsatz der Verhältnismäßigkeit in der Rechtsprechung der Gerichte der Europäischen Gemeinschaften', (1999) Neue Zeitschrift für Verwaltungsrecht (NVwZ) 1033, with further references. See futher *infra* n. 239.

235 See R Streinz, *Europarecht*, 3rd ed., 1996, no. 93. See also Part 2 Chapters 5 and 6 *infra* for the occurrence of this principle in the UK and the Netherlands.

236 See Article 6(2) EU.

237 For a comparative analysis of the application of the principle of proportionality in the EU Member States, see J Schwarze, *Europäisches Verwaltungsrecht*, Band (Volume) 2, 1988, pp. 663 *et seq*.

against this background that this principle is recognized as a fundamental part of the legal system of the European Union, and generally accepted as an overarching legal principle of all Community measures. It is also seen as an overarching rule in the case law of the ECJ.[238]

Article 5(3) EC only codifies one part of the principle of proportionality, which stipulates that no action by the Community shall go beyond what is necessary to achieve the objectives of the Treaty (the necessity leg of the test). The other two legs of the proportionality test, i.e. the appropriateness of a Community measure to achieve a permissible objective and the proportionality in a specific sense (meaning that the peculiarities or pros and cons of a specific case have to be adequately weighed and deliberated), are not mentioned explicitly although they are recognized by the ECJ as being a substantive part of the test. This does, however, not mean that the proportionality test under Community law is limited to assessing whether the mildest means have been chosen by Community institutions, and that the test does not prohibit a disproportionate or inadequate restriction of legal entitlements or rights. It is recognised that Article 5(3) EC has to be read in such a way as to comprise all three legs of the proportionality test as developed by the ECJ, which is thus primary EC law.[239]

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238 Von Bogdandy in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. I, Article 3b, no. 43. The ECJ, which has, until its explicit codification in Article 3b EC (now Article 5(3) EC), recognized in its case law the principle of proportionality as a general principle of Community law, see C-265/87 – *Schräder*, (1989) ECR I-237. As regards the evolution of this principle in the case law of the ECJ, see, in great detail, Pache, n. 234, p. 1034. Since *Internationale Handelsgesellschaft* (C-11/70, (1970) ECR 1125, 1135 *et seq.*), the ECJ has been applying this principle when assessing restrictive Community measures, see Pache, *ibid.*, 1034.

239 Confirmed by the BVerfG, BVerfGE 89, 155, 212 *et seq.* See also von Bogdandy, *ibid.*, which refer to the case law of the European Court for Human Rights as regards "measures necéssaires" in Articles 8–11 ECHR and Article 2 of the 4th Protocol, as well as Article 14 ECHR. In the legal system of the EU, the principle of proportionality is part of the primary Treaty law, and therefore has priority over secondary law such as Regulations and Directives. The various legal systems of the EU Member States obviously have different views on the exact scope of this principle. Whereas the English merely assess the necessity of state measures, see *R* v *Goldsmith*, (1983) 1 Weekly Law Reports (W.L.R.) 151, 155, and further in Part 2 Chapter 5 *infra*, the Germans, on the other end, look into the adequateness of state measures by including a weighing or balancing of the different interests, i.e. the ones, which are to be permitted, and those, which will be restricted, see the hightest German court in public law matters, the Bundesverwaltungsgericht (BVerwG), BVerwGE 45, 51, 59 *et seq.*, and H Maurer, *Allgemeines Verwaltungsrecht*, 11th ed., 1997, p. 234 with further references. Keeping this in mind, the substantial requirements, which the ECJ attributes to the principle of proportionality, illustrate well the independent development and growing detail of a general principle of law in European law. Nevertheless, the ECJ substantially follows the ideas developed under the German legal tradition with regard to the scope of the principle of proportionality, see T Oppermann, *Europarecht*, 2nd ed., 1999, nos 514, 521, and E Sullivan, 'Antitrust remedies in the U.S. and EU: advancing a standard of proportionality', (2003) Antitrust Bulletin (Summer 2003) 414, with an excellent English language overview over the modalities of this principle. See also P Larouche, 'Legal Issues Concerning Remedies in Network Industries', in D Geradin

The ECJ formulates the requirements of the principle of proportionality as follows: "By virtue of the principle of proportionality, measures imposing financial charges on economic operators are lawful provided that the measures are appropriate and necessary for meeting the objectives legitimately pursued by the legislation in question. Of course when there is a choice between several appropriate measures, the least onerous measure must be used and the charges imposed must not be disproportionate to the aims pursued."[240]

The application of the principle of proportionality finds different expressions in the case law of the EC Courts (European Court of Justice (ECJ) and Court of First Instance (CFI)), depending on whether it is applied to actions of executive bodies such as the Commission when enforcing EC competition law or applied in the context of reviewing legislation; as regards the latter, the ECJ accepts a wide margin of appreciation of the legislature.[241]

The case *Alrosa* decided by the CFI gives excellent insights into how the EC Courts would apply the principle of proportionality to a contested Decision of the Commission based on Article 7 of Regulation 1/2003 in the context of an

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(ed.), *Remedies in Network Industries: EC Competition Law vs. Sector-specific Regulation*, 2004, p. 25. Today, the ECJ and the CFI assess the three legs of the principle of proportionality in the style of the assessment under German law, see Pernice in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. III, Article 164, no. 101.

240 *ECJ*, C-265/87 – *Schräder*, n. 238. Financial charges or fines are the usual remedies or responses to an undertaking's anticompetitive behaviour.

241 See only ECJ, C-280/93 – *Banana Markets*, (1994) ECR I-4973, nos 88–94: "It should be pointed out in this respect that in matters concerning the common agricultural policy the Community legislature has a broad discretion which corresponds to the political responsibilities given to it by Articles 40 and 43 of the Treaty. The Court has held that the lawfulness of a measure adopted in that sphere can be affected *only if the measure is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue.* More specifically, where the *Community legislature* is obliged, in *connection with the adoption of rules, to assess their future effects, which cannot be accurately foreseen, its assessment is open to criticism only if it appears manifestly incorrect in the light of the information available to it at the time of the adoption of the rules* in question […]. The *Court's review must be limited in that way in particular if, in establishing a common organization of the market,* the Council has to reconcile divergent interests and thus select options within the context of the policy choices which are its own responsibility […]. While other means for achieving the desired result were indeed conceivable, the *Court cannot substitute its assessment for that of the Council as to the appropriateness or* otherwise of the measures adopted by the Community legislature if those measures have not been proved to be *manifestly inappropriate for achieving the objective pursued* (emphasis added)." See in greater detail in chapter 7 on the European Union. With respect to the reluctant enforcement of the proportionality principle by the ECJ in cases where the proportionality of fundamental rights restricting legislation is at issue, see M Schmidt-Preuß, 'Der Wandel der Energiewirtschaft vor dem Hintergrund der europäischen Eigentumsordnung', (2006) Europarecht (EuR) 463. See also ECJ, Joined Cases C-20/00 & C-64/00 –*Booker Aquaculture*, (2003) ECR I-7411, where the ECJ seems to show a rather mature and balanced understanding of the principle of proportionality.

alleged abuse of the dominant position of vertically integrated energy network operators[242]:

> "In order to attain that objective [i.e. ensuring the effective application of the competition rules laid down under the EC Treaty], the Commission possesses a margin of discretion in the choice offered to it by Regulation No 1/2003: it may make the commitments proposed by the undertakings concerned binding through the adoption of a decision under Article 9 of that regulation, or it may follow the procedure laid down under Article 7(1), which requires that an infringement be established. […] [T]he principle of proportionality requires that the measures adopted by Community institutions must not exceed what is appropriate and necessary for attaining the objective pursued (Case T-260/94 Air Inter v Commission [1997] ECR II-997, paragraph 144, and Van den Bergh Foods v Commission, paragraph 201); when there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued (Case 265/87 Schräder [1989] ECR 2237, paragraph 21, and Case C-174/05 Zuid-Hollandse Milieufederatie and Natuur en Milieu [2006] ECR I-2443, paragraph 28). The review of the proportionality of a measure is thus an objective review, since the appropriateness of and the need for the contested decision must be assessed in relation to the aim pursued by the institution. For decisions adopted under Article 7 of Regulation No 1/2003, the aim is to put an end to the infringement which has been established […]. In cases to which Article 7(1) of Regulation No 1/2003 applies, the Commission has to establish the existence of an infringement, which implies a clear definition […] of the abuse for which the undertaking in question is alleged to be responsible."[243]

The CFI clarifies that "the burdens imposed on undertakings in order to bring an infringement of competition law to an end must not exceed what is appropriate and necessary to attain the objective sought, namely re-establishment of compliance with the rules infringed."[244]

The CFI further establishes that the Commission can only take a decision lawfully under Article 7(1) of Regulation 1/2003 if it is necessary to re-establish the situation which existed prior to the infringement.[245]

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242 CFI, T-170/06 – *Alrosa* v *Commission*, (2007) ECR II-2601. *Alrosa* is concerned with the distinction between Article 7 and Article 9 (commitments offered by the undertakings under investigation) Regulation 1/2003 and the application of the proportionality principle in both contexts.

243 CFI in re *Alrosa*, n. 242, nos 95–100.

244 CFI in re *Alrosa*, n. 242, no. 102, referring to ECJ, Joined Cases C-241/91 & C-242/91 – *Magill*, (1995) ECR I-743, no. 93.

245 CFI in re *Alrosa*, n. 242, no. 103, referring to CFI, T-24/90 – *Automec* v *Commission*, (1992) ECR II-2223, nos 51 and 52.

Whereas the legislature possess a margin of appreciation when passing legislation, which is reviewed by the EC Courts only for manifest or obvious errors, the margin of discretion accepted for decisions by the Commission as the executive institution of the European Union[246] is narrower and subject to full judicial review by the EC Courts[247], as is also the Commission's decision whether or not to undertake a complex economic assessment prior to acting.[248] Only if measures of the Commission (have to) involve a complex economic assessment[249], is the measure taken by the Commission subject to a *limited* judicial review.[250] With respect to executive measures, full judicial review is accepted as self-evident by the EC Courts because of the effect decisions taken under Articles 81 and 82 EC have on fundamental economic freedoms guaranteed by the Treaty.[251]

The EC Courts in recognizing that the analysis which the Commission is required to carry out in the context of Article 7(1) of Regulation No 1/2003 (as well as in the context of Article 9(1)) concerns *existing practices*, not only determine on their own account whether their review is limited, i.e. whether the Decision of

246 See CFI in re *Alrosa*, n. 242, no. 108, where the CFI states that "[…] the level of review carried out by the Court of the analyses carried out by the Commission on the basis of the competition rules of the Treaty must take into account the margin of discretion which underlies each decision under consideration and is justified by the complexity of the economic rules to be applied."

247 And not just limited to manifest errors of assessment, see CFI in re *Alrosa*, n. 242, no. 110.

248 In CFI in re *Alrosa*, n. 242, no. 125, the CFI, for instance, established that the Commission did not have to carry out a complex economic assessment, which justified a limitation of the review to be undertaken by the Court of the Decision. *Alrosa* was concerned with a Commission Decision prohibiting absolutely any future trading relations between certain companies active in the world diamond market.

249 Which, according to the CFI in re *Alrosa*, n. 242, (see no. 108, which refers to ECJ, C-12/03 P – *Tetra Laval* v *Commission*, (2005) ECR I-987, nos 38–40) is *per se* the case in "[…] fields, such as concentrations, where the existence of a discretionary power is essential to the exercise of the powers of the regulatory institution." The CFI in *Alrosa*, no. 109, by referring to settled case law (CFI, T-158/00 – *ARD* v *Commission*, (2003) ECR II-3825, nos 328 and 329) accepts that the Commission when reviewing notified concentrations in the area of merger control, enjoys a broad discretion in assessing the necessity of obtaining commitments in order to dispel the serious doubts raised by such notified concentrations. "The review limited to manifest error which the Court undertakes in *that field* is justified by the prospective nature of the economic analysis carried out by the Commission in order to be able to find that the concentration in question will not create or strengthen a dominant position (Case T-102/96 Gencor v Commission [1999] ECR II-753, paragraph 163) (emphasis added)."

250 See CFI in re *Alrosa*, n. 242, no. 108. Such limited judicial review is confined to verifying whether the rules on procedure and on the statement of reasons have been complied with, whether the facts have been accurately stated and whether there has been any manifest error of appraisal or misuse of powers. See CFI in re *Alrosa*, n. 242, no. 122, referring to ECJ, Joined Cases C-204/00 P, C-205/00 P, C-211/00 P, C-213/00 P, C-217/00 P & C-219/00 P – *Aalborg Portland & Others* v *Commission*, (2004) ECR I-123, no. 279.

251 See CFI in re *Alrosa*, n. 242, no. 108. This, it is submitted, contrasts starkly the tendency of the EC Courts to afford a wide margin of appreciation to the European legislature with respect to legislative measures enacted.

the Commission involved a complex economic assessment, but also whether and, if so, to what extent there was a more appropriate and less onerous solution possible in order to achieve the aim pursued by the Decision.[252]

In *Alrosa*, the CFI also reiterates that "since the object of Article 82 EC is not to prohibit the holding of dominant positions but solely to put an end to their abuse, the Commission cannot require an undertaking in a dominant position to refrain from [acting in a manner] which allow it to maintain or to strengthen its position in the market, if that undertaking does not, in so doing, resort to methods which are incompatible with the competition rules. While special responsibilities are incumbent on an undertaking which occupies such a position […], they cannot amount to a requirement that the very existence of the dominant position be called into question."[253]

Alrosa shows how the EC Courts check the proportionality of a remedy selected as a result of the application of Article 7 of Regulation 1/2003, which requires a remedy to be proportionate to the infringement committed and necessary to bring the infringement *effectively* to an end.[254]

More precisely, the proportionality of an effective remedy means that it is appropriate (in terms of being capable) and, narrowing it down, is necessary (in

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252 CFI in re *Alrosa*, n. 242, nos 126, 128. The *Alrosa* case is also highly relevant in the context of Germany's energy groups E.ON's and RWE's commitments (see Article 9 Regulation 1/2003) to divest "voluntarily" (i.e. unbundle ownership) of their German electricity and gas transmission networks, respectively, as a consequence of investigations by the Commission into allegedly anticompetitive practices, see European Commission, 'Antitrust: Commission welcomes RWE proposals for structural remedies to increase competition in German gas market', MEMO/08/355, 31 May 2008, and 'Antitrust: Commission welcomes E.ON proposals for structural remedies to increase competition in German electricity market', MEMO/08/132, 28 February 2008. No. 156 states that "[…] other solutions existed that were proportionate to [the] objective [of the Decision]. In making use of the procedure allowing commitments offered by an undertaking concerned to be made binding, the Commission was not relieved of its duty to apply the principle of proportionality, which requires in this case that there be an appraisal *in concreto* of the viability of those intermediate solutions." It seems that before rendering decisions in the E.ON and RWE cases, which make the commitments to divest energy networks binding, the Commission has the duty to consider alternative solutions first, which are capable of resolving any infringements of Article 81 or 82 EC committed by these two vertically integrated energy supply undertakings.

253 CFI in re *Alrosa*, n. 242, no. 146, referring to ECJ in re *Michelin*, n. 252, no. 57.

254 Article 7 is to be read in conjunction with its interpretation as set out in Recital 12 of Regulation 1/2003. The proportionality test used in the context of the Modernization Regulation and as set out in its recital 12 is a refinement of previous case law such as the ECJ judgement in re *Magill*, n. 244. A remedy therefore is not of a punitive nature but should merely restore the competitive process impaired by the infringement., see I Forrester, 'Modernisation, an extension of the powers of the Commission?', in D Geradin (ed.), *Modernization and Enlargement: Two Major Challenges for EC Competition Law*, 2004, p. 97, rightly claims that the remedy "must be approved both from a legal certainty and from a human rights point of view."

terms of being the least onerous equally effective measure), to end an infringement and restore the proper functioning competitive process harmed by the infringement, which is the main prerequisite for achieving the EU's overarching objective, a common market. It further means that an effective remedy must observe (actual) proportionality, taking (after due weighing and deliberating) account of the circumstances and merits of a case.[255] Hence, this balancing test must also take economic efficiency into account.[256] Both principles, "legal" proportionality and economic efficiency, are related and proportionality should also be interpreted taking account of economic efficiency when considering a remedy.[257] It is the core of a proportional remedy to avoid excessive intervention, or in other words, a remedy is proportional to the triggering abuse and its effects in the market, if the remedial restrictions placed on the abusive dominant undertaking do not exceed the benefits achieved. It is the ultimate goal of competition law and therefore of the remedies chosen under Article 82 and the Modernization Regulation to restore competition, not merely to stop the anticompetitive harm and to prevent its recurrence. Proportionality that measures anticompetitive harm in relation to the restoration of competition in the market by considering how the market would have existed had the abusive conduct not occurred, makes ex post competition law remedies more efficient.[258]

Whether a behavioural or structural remedy is to be chosen must be considered as part of the necessity or second leg of the proportionality test. After the determination of an infringement of Article 81 or Article 82 EC, the adoption of a behavioural remedy is the rule, whereas a structural remedy is the exception, as can be inferred from Article 7 Modernization Regulation and its interpretation

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255 In particular to find the right balance between resolving competition concerns and the intervention in fundamental (economic) rights.

256 For the definition of econmic efficiency and its components, see Motta, n. 54, pp. 40 *et seq.*, and Whish, n. 122, pp. 2–4.

257 *Cf.* Recitals 1, 9, 11, 12 and 25 Modernization Regulation, which assume that (a certain level of) competition exists in the internal market and, thus, must not be distorted and be protected. Consequently, by bringing an infringement of competition to an end, at least the previous level of competition has to be restored. Sullivan, n. 239, pp. 424–5, states: "Proportionality […] should include the competition goal of restoring rivalry to the market. If there is not congruence between the harmful effects in the market and the remedy, the enforcement will create the wrong incentives; it may either overdeter or underdeter competitive conduct. *An antitrust remedy cannot be efficient in an economic sense unless it is proportional to the anticompetitive harm and relevant to returning the industry to a competitive pasture.*" Referring to EU practice, Sullivan continues: "[…] proportionality needs to be defined more broadly, especially when serious barriers to entry are present. […] *By defining proportionality in this way* [the European way] we will come closer to an *efficient* remedy – one that will deter further illegal conduct, create appropriate competitive incentives, and restore competition to the market. In the end, the remedial goal should embrace a *test of efficiency*" (comment and emphasis added).

258 See also Sullivan, n. 239, p. 425.

in Recital 12: the Commission is only authorized to impose a structural remedy either where there is no *equally effective* behavioural remedy or where, for the undertaking concerned, a structural remedy would be less burdensome than any equally effective behavioural remedy, which means the discretion of the Commission has been limited by the legislator. This limitation is clearly reflected in the CFI's judgement in re *Alrosa*.[259]

From this it follows that the Commission would not be able to prefer structural over equally effective behavioural remedies even if it argued that the costs related to the implementation and monitoring of an equally effective behavioural remedy are so high as to undermine its effectiveness.[260] The Modernization Regulation 2003, in recognizing the residual nature of structural remedies in *ex post* intervention gives more weight to the fundamental economic rights of the shareholders of the undertaking allegedly guilty of abusive behaviour than to the competition enforcement competence of the Commission and possible enforcement cost considerations.[261]

This line of argument is also reflected in the fact that being a dominant undertaking, which involves owning the assets on which the dominance is based and thus being structured in a certain way, does not contravene European law, but only the abusive use of such assets.[262] Behavioural remedies target abusive conduct, i.e. the abusive use of property, whereas structural remedies, which include any form of unbundling, also intervene in the very core of property rights, i.e. the possession of property itself *and* its enjoyment (i.e. its use). The sheer fact that an undertaking is dominant as a result of its structure, as is the case with vertically integrated energy network operators, which just have the

259 In *Automec*, n. 245, no. 52, the CFI states "it is not for the Commission to impose upon the parties its own choice among all the various potential courses of action which are in conformity with the Treaty."

260 Costs are a matter of the efficiency of a remedy; enforcement costs will therefore play a role when testing a remedy's efficiency, see below. In any event, what might already be indicated here is that the cost argument with regard to the implementation and monitoring of behavioural remedies should no longer serve as the main argument against such remedies. This is because the Commission, in the course of implementing behavioural remedies, is increasingly installing external private trustees, not only in merger cases but also in the ex post application of competition law, see already n. 168. See also J Killick, 'IMS and Microsoft Judged in the Cold Light of IMS', (2004) 2 CompLRev 23.

261 It has in any event already been shown that with the current state of the law (and based on regulatory costs *already* incured), effective regulation and thus the remedying of abusive behaviour of energy network monopolies is indeed possible, in particular that cross-subsidies can be detected and suppressed, see NMa, n. 156.

262 See also L Hancher, P-A Trepte, 'Competition and the Internal Energy Market', (1992) ECLR 149, 156.

"potential" for abusive conduct[263], would seem not to suffice to impose structural remedies, however, as dominance is not prohibited under EC law.[264]

Should, nevertheless, the imposition of a structural remedy be seriously considered, then the proportionality test is strict in that the Commission can only impose such a remedy if it considers that there is a risk of a lasting or repeated abuse deriving from the *very structure* of the undertaking (and then only if there is no equally effective behavioural remedy available).[265] Care must however be taken that the distinction between the structure of the undertaking and its conduct does not blur, which would undermine the difference between the dominant position and its abuse.[266]

The substantial risk of a lasting or repeated abuse[267] means that the Commission has to conduct a prognosis (or prospective analysis) regarding a future continuous risk of abuse as the result of an established infringement. For a prognosis of the *risk* of a lasting or repeated abuse to be as accurate as possible, it is submitted that the current established abuse does not of itself suffice as an indication of lasting or repeated abuse but that in the past there should have been similar abuses established. This is because the *mere capability* or incentive for anti-competitive behaviour[268], which, for instance, vertically integrated energy network operators

263 CFI in re *Alrosa*, n. 242, no. 146.

264 Unless abuse is the direct and unavoidable result of the undertaking's dominance, see the ECJ's approach in cases where Article 82 EC is applied in combination with Article 86 EC, such as in re *Silvano Raso*, n. 202, no. 29, where the Court states that "[m]erely exercising its monopoly will enable it to distort in its favour the equal conditions of competition between the various operators on the market in dock-work services." It held that Article 82 EC was infringed because as a result of the monopoly position in the upstream market, the dominant firm was not capable of avoiding the abuse of its position when operating downstream. Consequently, the structural remedy adopted removed the exclusive right in the upstream market. Similar A Tajana, 'If I had a hammer… Structural remedies and abuse of dominant position', (2006) Competition and Regulation in Network Industries (CRNI) 3, 15.

265 Recital 12 of Regulation 1/2003 states: "Changes to the structure of an undertaking *as it existed before the infringement was committed* would only be proportionate where there is a substantial risk of a lasting or repeated infringement that derives from the very structure of the undertaking (emphasis added)." The phrase "[…] as it existed before the infringement was committed […]" seems to serve only as a link of the structure of the undertaking with the infringement committed.

266 Article 82 EC covers only conduct or positive action. It should therefore not deal with the mere possibility of such conduct or action. The risk of such an approach has been pointed out by Advocate General Darmon in ECJ, C-18/88 – *RTT* v *GB-Inno-BM*, (1991) ECR I-5941, no. 44: "[…] the assimilation of the mere possibility of prohibited conduct to such conduct is problematic. Such assimilation would signify passing from a repressive scheme of rules, where proof of the prohibited conduct must be adduced, to a preventive scheme of rules where the presumption that there will be such a conduct suffices."

267 For such a risk in the context of network industries, see section II (2) of this chapter *infra*.

268 Capability and incentives are part of the economic efficiency analysis of structural remedies, which are dealt with in section II (3) of this chapter *infra*.

inherently have, does not in itself amount to a *risk* that such behaviour will in fact take place.

A prognosis appears to contradict the concept of ex post intervention of the Modernisation Regulation in that the Commission would not only bring an infringement to an end but also would have to consider the possible future conduct of the undertaking concerned. But in doing so, the Commission, in only being authorized to find the least onerous effective remedy, merely endeavours to bring the current infringement effectively to an end by preventing the undertaking from committing similar infringements in the future.[269] Therefore, as the Article 7 power to adopt remedies is competition law enforcement, and not a regulatory competence, it must ensure that the adoption of a remedy always focuses on its primary purpose, namely the termination of the infringement in question, and on the likelihood of the same abuse being committed again in the near future only as one aspect in this context.[270] Thus, in order for a remedy to *effectively* terminate an abuse, the exact features of the current abuse and how it came about must be established so that it cannot, not even potentially, continue into the future. This prognosis therefore serves and reflects the primary goal of a remedy not only to terminate an infringement but also to restore competitive market conditions.[271] The prognosis, it is submitted, must thus also take the remedy, which is to be chosen to end an infringement into consideration in order to show what might probably change as a result of the implementation of such remedy.[272]

Further, in order to restrict the regulatory role of the Commission as far as possible, the remedy chosen should always be related to the abuse it is supposed to cure, and should not influence the structure of the undertakings in the market nor should it be used as a tool to dictate regulatory policies and the behaviour of dominant undertakings.[273]

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269 Here again, the Commission as competition authority seems to assume a quasi-regulatory function as well, see already n. 223.

270 *Cf.* J Temple Lang, 'Anticompetitive Non-pricing Abuses under European and National Antitrust Law', in B Hawk (ed.), *International Antitrust Law and Policy*, Fordham Corporate Law 2003, chapter 14, p. 300.

271 This seems to be confirmed by the CFI in re *Alrosa*, n. 242, no. 103: "It follows that the Commission cannot, without going beyond the powers conferred on it both by the competition rules of the EC Treaty and by Regulation No 1/2003, adopt on the basis of Article 7(1) of that regulation a decision prohibiting absolutely any future trading relations between two undertakings unless such a decision is necessary to re-establish the situation which existed prior to the infringement (see, to that effect, Case T-24/90 *Automec* v *Commission* [1992] ECR II-2223, paragraphs 51 and 52)." See in this respect also n. 259.

272 Which is exactly what is determined in the context of evaluating the economic efficiency of a remedy, see in greater detail section II(3) of this chapter *infra*.

273 See Tajana, n. 264, (2006) CRNI 3, 16.

2. REFUSAL OF ENERGY NETWORK ACCESS: STRUCTURAL AND/OR BEHAVIOURAL REMEDIES?

As indicated towards the end of the previous subsection, a typical setting where a structural remedy would be considered is in network industries[274], featuring vertically integrated monopolistic network businesses, which naturally hold a dominant position in their market. Here, a substantial risk of a lasting or repeated infringement of Article 82 EC, typically in the form of direct or, more likely, disguised refusal to supply access to the vertically integrated energy networks[275], that derives from the *very structure of the dominant undertaking* (i.e. a clear and direct link between the structure of a dominant undertaking and its abuse) seems to be evident.

There are two ways of dealing with exclusionary abuses, and more specifically with refusal to supply access, of vertically integrated energy network operators, which are either by intervening with a structural remedy imposed on the energy supply undertaking, which vertically integrates the energy network operator, requiring the divestiture of either the potentially competitive or the monopolistic network activities[276], or through mandating Third Party Access (TPA) for up- and downstream competitors to the energy networks, which would be a behavioural remedy.[277]

Imposing a structural remedy such as divestiture (legal ownership unbundling) would, however, seem to be a draconian form of resolving competitive harm.[278]

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274 Motta, n. 54, pp. 82–3.

275 See also for other potential abuses, chapter 1 section III *supra*.

276 Or through, e.g., enforcing a less rigorous structural remedy like legal unbundling as pursued in re *Deutsche Post*, n. 232. In the energy sector, this is, however, not an option any more since legal unbundling of the energy networks is already in place.

277 Industry-wide TPA is already mandatory as a result of sector-specific regulation (except for upstream gas pipeline networks, which link gas production projects with processing plant or coastal landing terminals, Articles 2(2), 20 Gas Directive 2003), but see also n. 441 and accompanying text. Ordering individual energy network operators in a competition law context to allow TPA is usually the consequence of disguised refusal to supply such access. This remedy was part of the *Marathon* commitments, see n. 193. Competition law enforcement based TPA might require extensive and costly monitoring. On the other hand, as has been established before, cost cannot play a role when considering the effectiveness of a remedy. Moreover, the cost of monitoring may also have to be borne by the perpetrator, see n. 168.

278 See Larouche, n. 239, p. 36; M Motta and A de Streel, 'Exploitative and Exclusionary Excessive Prices in EU Law', presentation at 8th Annual EU Competition Law and Policy Workshop, Florence, June 2003, mimeo. Not further elaborated here are collective abuses of dominant positions, e.g. in the form of cross shareholdings between competitors (for an example, see CFI, T-68/89 – *Società Italiana Vetro* v *Commission*, (1992) ECR II-1403) and collective dominance cases not based on structural links but rather reflecting market characteristics (such as oligopolistic settings; see, e.g., CFI, T-342/99 – *Airtours* v *Commission*, (2002) ECR II-2585, CFI, T-193/02 – *Piau* v *Commission*, (2005) ECR II-209, and ECJ, C-396/96 – *Compagnie Maritime* v *Commission*, (2000) ECR I-1365).

Rather, following the requirements of proportionality, milder (behavioural) alternatives, which are less restrictive as regards the legal position of the subject of the remedy but equally effective in bringing an established infringement to an end, have to be explored first.[279]

Such a milder but equally effective alternative might be the ordering of TPA, which in the context of monopolistic network *infra*structures, would be the result of the establishment of a duty of the *infra*structure operator to supply access.

Such a duty may be based on the application of the European form of the so-called "essential facilities" doctrine[280], according to which vertically integrated undertakings owning network facilities may under certain (exceptional) circumstances be required to supply an input not only to its related up- or downstream businesses, but also to competing firms on fair and non-discriminatory terms and conditions[281], thereby granting them third parties access (TPA). The application of the essential facilities doctrine does in fact also have structural effects because entry into the related market is facilitated.[282]

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279 See Sullivan, n. 239, pp. 414 *et seq.*, for the application of the principle of proportionality in a structural remedy setting. The search for an equally effective but milder or less onerous remedy would be part of the necessity leg of the proportionality test.

280 The essential facilities doctrine originates from U.S. case law, such as *United States* v *Terminal Railroad Association of St. Louis*, 224 U.S. 383 (1912) and 236 U.S. 194 (1915), and *Otter Tail Power Co.* v *United States*, 410 U.S. 366 (1973), see M Bergman, 'The role of the essential facilities doctrine', (2001) Antitrust Bulletin (Summer 2001) 433. This doctrine has, however, never been recognized by the U.S. Supreme Court, see lately in re *Trinko*, n. 141. Refusal to grant competitors access can also constitute an infringement of Article 81 EC Treaty, see D Glasl, 'Essential Facilities Doctrine in EC Anti-trust Law: A Contribution to the Current Debate', (1994) ECLR 306. The question of exclusionary refusals to deal (supply) by dominant undertakings, albeit in a non-integrated setting, was first analysed in the EU by the ECJ in re *Commercial Solvents*, n. 196.

281 Economically, the compulsory duty to deal under the doctrine includes a form of indirect price regulation. The effect of the doctrine is similar to the effect of direct price regulation of the essential facility as a stage of production, where prices will be reduced, which is likely to also bring prices down in the related market. Its application results in a short-term positive effect on competition in the related market, from which consumers will benefit. However, the price reduction will decrease a monopolist's (here the owner of a monopolistic bottleneck) profit and is therefore likely to reduce the monopolist's incentives to invest. Under which circumstances the application of the doctrine is justified depends on whether it is possible to sufficiently determine that the net effect of applying the doctrine is likely to be beneficial (or consumer welfare enhancing). Short-term competitive effects and long-term disincentives to invest should be adequately weighed. The doctrine should only be applied if its long-term efficiency can be shown; but see *infra* section II 3 of this chapter as regards the inclusion of an efficiency criterion in the proportionality test. For an economic analysis of the essential facilities doctrine, see Bergman, *ibid.*

282 In contrast to direct price regulation or challenges of excessive (and therefore abusive) prices charged to competitors in a related market, Bergman, n. 280. The essential facilities doctrine constitutes an intervention in property rights, because dominant firms are forced to allow

In the EU, the "essential facilities" doctrine, a term, which has actually never been used by the ECJ, was introduced in Magill[283] as a concept of "exceptional circumstances", forcing the owner of a network facility, which it was unreasonable or impracticable to duplicate, to grant access to competitors. This concept was refined in *Bronner*[284] and *IMS*[285] where three conditions for compelling network owners to grant access were set out by the ECJ.[286] First, for a facility to be essential, the refusal of access to a facility must be likely to eliminate any

competitors the use of their facilities. It, however, restricts the use of property, not its structure.

283 N. 239.

284 ECJ, C-7/97, n. 143. In this case, however, the "essential facility" character of a nation-wide newspaper distribution scheme was rejected (because the duplicability of such a scheme was considered not to be unreasonable) and thus another important issue which was raised but was not further discussed, see critically in this regard, Hancher, n. 54. This issue was about the fact that the owner made the scheme available to everyone only under certain published conditions applicable to everyone in a non-discriminatory manner; these conditions could, however, not be fulfilled by the complainant Bronner. In the context given here, the question thus arises whether and if so how competition authorities should enforce competition law when an energy transmission system operator (TSO), vertically integrated or not, allows one energy supplier exclusive access to its network(s) and thus refuses access to any other energy supplier. As has already been established, access to energy transmission networks is indispensible for competitors in the related up- and downstream energy supply markets; they are also limited in capacity. Further, as is explained in chapter 3 *infra*, energy networks and thus also access to them is regulated; new energy networks may be eligible to exemptions from the obligation to grant non-discriminatory access under the conditions of Article 7 Regulation 1228/2003 and Article 22 Gas Directive 2003, see also n. 290 and chapter 3 *infra*; see also Part 2 Chapters 5 and 6 on Great Britain and the Netherlands on how such exemptions are dealt with in practice; see further the Commission's website as regards the exemptions granted so far, ec.europa.eu/energy/*infra*structure/*infra*structure/electricity/electricity_exemptions_en.htm and ec.europa.eu/energy/*infra*structure/*infra*structure/gas/gas_exemptions_en.htm. Competition authorities having to deal with TSOs refusing access to all but one energy supplier would thus have to ensure that such behaviour is resolved similar to (independent merchant) transmission eligible for such exemptions, which would involve the determination of access rules similar to the exemptions in a regulatory setting, such as a certain period of time being allowed to grant exclusive access (in order to alleviate the risk of investment by inter alia receiving a steady return) accompanied by a so-called use-it-or-lose-it obligation, n. 199, and upon expiry of that period to comply with regulation. On regulated and unregulated investment in electricity transmission networks from an economic point of view, see Brunekreeft, n. 200.

285 EC, C-418/01, *IMS Health* v *NDC Health*, (2004) ECR I-5039. A fourth condition applied in *Magill*, n. 244, i.e. the refusal of access must prevent the emergence of a new product for which there is consumer demand, appears to be an intellectual property specific condition. The concept also played a central role in the recent *Microsoft* case, see n. 168.

286 For criticism voiced, see e.g. Hancher, n. 54; Petit, n. 141. On the "essential facility" doctrine more generally, J Temple Lang, 'The principle of essential facilities in European Community competition law – the position since Bronner', (2000) Journal of Network Industries 375; D Geradin, 'Limiting the scope of Article 82 EC: What can the EU learn from the U.S. Supreme Court's judgment in *Trinko* in the wake of *Microsoft*, *IMS*, and *Deutsche Telekom*?', (2004) CML Rev. 1519. From a law and economics perspective, G Werden, 'The Law and Economics of the Essential Facilities Doctrine', (1987) Saint Louis University Law Journal 433. On the economics behind the "essentail facilities" doctrine, see also Motta, n. 54, pp. 66–9, 339 (note 33), 490.

competition on a related market (in other words, access is necessary to compete in a related market). Secondly, the access to the facility must be indispensable for a competitor in the related market, and the facility must be technically, legally or economically not reasonably possible to duplicate. And finally, access must be denied without any objective justification.[287]

In particular with respect to the rather vague second condition[288] – the facility must be *not reasonably possible* to duplicate (which is normally the case in natural monopolies such as energy network *infra*structures) – it is submitted that the doctrine should only be applied if access for competing firms is expected to increase competition substantially, and not applied if such access would reduce the incentives to invest (as competition would then unlikely to be increased).[289] The reason for this submission is that the application of the essential facilities doctrine (or exceptional circumstances concept) has been criticized as creating disincentives for both network owners and potential competitors to innovate and invest.[290] Disincentives for network owners may be the result of too broad an application of this concept (exceeding its original application in pure non-

287 It is rightly claimed that once a network facility is identified as essential, the burden of proof lies on the operator to show that a valid commercial justification for a refusal to supply access exists, Hancher, n. 54, p. 1303. It is submitted, that this shift in burden of proof can indeed happen rather quickly as a result of the fairly vague second condition, which would leave the impression that the owner of the network facility is under a duty to protect its competitors rather than competition itself, *cf.* Hancher, *ibid*. The German notion of the "essential facilities" doctrine as put down in s. 19(4) no. 4 GWB seems to be more responsive and flexible in that denial of access can be justified if impossible or *unreasonable* ("nicht zumutbar"). Further, the doctrine explicitly applies to *infra*structure facilities only. See also A Heinen, 'Access to Electricity Networks: the Application of the 'Essential Facilities Doctrine' by the German Federal Cartel Office', (2001) Journal of Network Industries 385, 393. On the other hand, such deviation could conflict with the "essential facilities" doctrine as applied by the ECJ, which might result in the non-applicability of German law, see nn. 170, 231.

288 See also the criticism voiced by Hancher, n. 54, p. 1305.

289 *Cf.* P Areeda, 'Essential Facilities: An Epithet in Need of Limiting Principles', (1989) Antitrust L.J. 841. See also Knieps, n. 54, with respect to the requirement of network facilities to be monopolistic bottlenecks.

290 See n. 281. Exceptions to TPA for new investment are, however, available according to Article 7 EC Regulation 1228/2003 and Article 22 Gas Directive 2003; such exception have already been applied to interconnection *infra*structures in several EC Member States, see n. 284 and, in greater detail, *infra* in Part 2 Chapters 5 and 6 on the UK and the Netherlands. Investment incentives for so-called merchant (unregulated) transmission usually include the exclusive right for investors, after a so-called open season procedure has been applied where investors can bid to take part in such *infra*structure investments, to have, for a certain period (nearly equating to the amortisation period of the investment), the exclusive right to the capacity of the interconnector investment; however, such rights are also normally subject to so-called use-it-or-lose-it obligations, see n. 199. On investment incentives for electricity transmission from an economic point of view, G Brunekreeft, K Neuhoff, D Newbery, 'Electricity transmission: An overview of the current debate', (2005) Utilities Policy 73.

duplicatable *infra*structure cases such as energy networks)[291] or the result of the negligence of its efficiency as remedy.[292] For potential competitors, such disincentives might result from the opportunity to free-ride on others' commercial advantages.[293]

With respect to non-discriminatory (pricing and non-pricing) access terms and conditions, the network operator forced to grant network access by way of application of the "essential facilities doctrine" is only allowed to treat access requests differently if objectively justifiable; otherwise, access must be provided in such a manner that the goods and services offered to competitors in related markets are available on terms no less favourable than those given to other parties, including their own corresponding operations.[294]

It has been claimed that applying the principle of non-discrimination[295] in such a way may prove difficult, as it would involve costly accounting adjustments by

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291 Areeda, n. 289. A good example may be the Commission Decision in re *Georg*, n. 193, where the Commission stretches the essential facilities doctrine beyond purely non-duplicable *infra*structure facilities. See for a brief discussion of this Decision, Petit, n. 141, pp. 351–2. It is submitted that strict adherence in terms of narrow interpretation of the criteria for the application of the essential facility doctrine would increase legal certainty, which is likely to give firms stronger incentives to invest. Here, it might be appropriate to draw conclusions from the U.S. Supreme Court's decision in re *Trinko*, n. 141, where the Court accepted that the possibility of exercising monpoloy power can be important to promote efficient competition in order to achieve investment and economic growth: policies based on sharing monopolistic *infra*structure facilities are in conflict with "the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities" (p. 8 of *Trinko*). See for an extensive discussion of this case, Petit, *ibid*., concluding (in n. 56) that the ruling of the ECJ in *IMS*, which confirmed *Bronner*, n. 143, seems to imply that the concept of exceptional circumstances should not be construed too extensively.

292 See n. 302. See also *ibid*.

293 Which is, however, not usually the case with respect to energy networks. AG Jacobs in *Bronner*, n. 143, states in no. 57 "[t]he justification in terms of competition policy for interfering with a dominant undertaking's freedom to contract often requires a careful balancing of conflicting considerations. In the long term it is generally pro-competitive and in the interest of consumers to allow a company to retain for its own use facilities which it has developed for the purpose of its business. For example, if access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities. Thus while competition was increased in the short term it would be reduced in the long term. Moreover, the incentive for a dominant undertaking to invest in efficient facilities would be reduced if its competitors were, upon request, able to share the benefits. Thus the mere fact that by retaining a facility for its own use a dominant undertaking retains an advantage over a competitor cannot justify requiring access to it."

294 CFI, Joined Cases T-374–375/94, T-384/94 & T-388/94, *European Night Services* v *Commission*, (1998) ECR II-3141, de Bijl/van Damme/Larouche, n. 54, p. 6. See also Petit, n. 141, pp. 354–5.

295 See nn. 205 *et seq*. and accompanying text.

the network operator and extensive control efforts by the competition authorities.[296]

Such arguments are, however, negligible with regard to energy network operators because, as has already been emphasized above, energy network operators are comprehensively regulated in terms of the principal sector-wide duty to grant non-discriminatory access, and in terms of tariffication and non-pricing (technical) access conditions such as network connection. Thus, enforcing TPA via competition law would "merely" be complementary to sector-specifically regulated TPA. Further, sector-specific regulation has also already imposed accounting unbundling and legal unbundling (both of which are of a structural nature) upon the sector so that extensive accounting adjustments are not necessary nor are extensive control efforts by the competition authorities, as such supervision is to a large extent already in place; also, competition authorities are either supposed to cooperate with regulators or regulators also have the competition law enforcement powers to apply the "essential facilities" doctrine to the energy networks.[297]

Consequently, determining exact access conditions should not pose too great a challenge to competition authorities, as has, by the way, already been shown in the *Marathon* case and the implementation of the remedies agreed there.[298] Also, the issue of economic efficiency of the remedy of competition law enforced TPA does not seem to be as critical as in the context of structural remedies because the energy supply industry is already subject to extensive TPA obligations.[299]

In conclusion, it can be said that in particular because competition law enforced TPA by way of the so-called "essential facilities" doctrine as a behavioural remedy with structural effects would be applied in an already regulated setting, it is indeed a milder, and, it is claimed here, equally effective alternative to the structural remedy of divestiture. The claim of equal effectiveness derives from the conclusions drawn from the economic considerations discussed in the next

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296 De Bijl/van Damme/Larouche, n. 54, p. 6, Hancher, n. 54. Further, such an obligation should only be applied to network operators, which have already been forced to grant access on the basis of the "essential facilities" doctrine, as otherwise it would involve the danger of imposing access obligations through the backdoor. In this respect, see de Bijl/van Damme/Larouche, *ibid*.

297 The exchange of data and regulatory support is not problematic from a legal point of view as competition authorities follow adjudicative procedures and thus possess ex officio investigation powers, which should normally allow them to find out and rely on any data relevant to the case at hand.

298 See n. 186 and van der Woude, n. 43, p. 12, explaining that in re *Marathon*, n. 177, there was actually a regulatory access regime laid down.

299 See nn. 277, 441, 444 and accompanying text.

subsection. Strictly speaking, those considerations are rendered in the context of the third leg of the proportionality test, i.e. the genuine proportionality of the structural remedy of divestiture. But the serious doubts raised in terms of efficiency of such a remedy also seriously question its effectiveness.[300]

The application of the essential facilities concept, on the other hand, can be effective immediately, in particular when considering that the competitions authorities can step (and already have stepped) into action at any time in a sector, which is already heavily regulated, and that they are equipped with the adequate tools and expertise (at least when cooperating with the sector-specific regulatory authority).

3. NECESSARY STRUCTURAL REMEDY: ALSO EFFICIENT?

Should, against what has just been established here, the structural remedy of divestiture of the energy networks of an individual vertically integrated energy supply undertaking be considered necessary in order to restore competition in the European energy markets, then, as has been shown above, the economic efficiency of such a remedy requires consideration as part of the proportionality of the remedy. Economic efficiency does not stop at finding an effective remedy. In the case of structural remedies, in particular divestiture, their effectiveness might conflict with their (economic) efficiency.

The question therefore is how to determine an efficient remedy. The characteristics of the industry to which the dominant undertaking belongs is the context within which the impact of a proposed remedy needs to be assessed.[301] This impact is

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300 Another argument in favour of the equal effectiveness of TPA enforced by way of the "essential facilities" concept compared to the structural remedy of divestiture can be inferred from the fact that energy supply security, which is one of the predominant objectives for the European Commission to be achieved throughout the EU, see chapters 1 and 3 section II, appears to conflict with the effectiveness of such a remedy. See in this regard the conclusions of the economic cost benefit analysis outlined in the next subsection, which seem to question the effectiveness of this structural remedy (at least as regards electricity transmission networks) if sufficient generation capacity is available, and the elaborations at the end of chapter 3 section II *infra*, which also outline the security of supply measures already taken by the European Union. See also the elaborations in chapter 3 on Article 175 EC and Article 194 TFEU (Treaty on the Functioning of the European Union (consolidated version), OJ 2008 C 115/47, 9.5.2008, as it would exist after the coming into force of the Lisbon Treaty, Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, 13 December 2007, OJ 2007 C 306/1, 17.12.2007). On the trade-off between the *ex ante* (dynamic) and *ex post* (allocative) efficiency of mandating TPA to an essential facility, in particular as regards its impact on the incentives to invest, Geradin, n. 286, pp. 1539, 1540.

301 For an account of the economic characteristics and an evaluation of remedies in network industries, see Cave, n. 148.

normally assessed by a so-called cost and benefit analysis, which also requires a close examination of the prospective performance of a proposed remedy.

An analytical framework for the evaluation of the costs and benefits of structural remedies in network industries must explore the competitive gains achieved by the remedy, which should exceed the anticompetitive costs associated with the conduct that caused the violation and any costs incurred by the remedy, while restoring competition to the market.[302]

A more detailed framework to analyse the costs and benefits of competition law enforced remedies has been proposed by *Larouche* where the following costs and benefits are relevant[303]:

1. for the competitors benefiting from the remedy, the cost if no remedy (or an insufficient one) is adopted (including the costs of withdrawal from the market or even bankruptcy), and the benefits they would have obtained had the remedy been imposed;

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302 Sullivan, n. 239, pp. 424–5. H Shelanski, J Sidak, 'Antitrust Divesture in Network Industries', (2000) University of Chicago Law Review 95, focus on a divestiture scenario in the context of the network bound telecommunication services industry and suggest a three-stage welfare test in which, first, the proposed remedy should produce a net gain in static economic efficiency, which aims at foreseeing how the market will react to the creation of an additional competitor (after the network has been divested), or how the market will react in the absence of the abusive conduct of the dominant firm after a *behavioural* remedy has been imposed; as to the necessity of assessing the economic efficiency of competition law enforced TPA, see *supra*. Secondly, the gains in static economic efficiency should outweigh the potential losses in dynamic efficiency: here, it is necessary to assess how a remedy might affect investment and innovation incentives, as dynamic efficiencies cannot be assumed by just relying on the effects of static efficiencies. Finally, enforcement cost would also have to be considered: an efficient remedy should minimize administrative, enforcement and transaction costs. According to such a cost and benefit analysis, a remedy is consumer-welfare enhancing only if the gains (losses) in static efficiency deriving from it are greater (lower) than potential losses (gains) in dynamic efficiency and costs related to its implementation, which can also be labelled as remedial efficiency. This test is designed to deal with network industries and the detrimental impact of an erroneous choice of remedies on investment and innovation incentives. In the electricity sector, investment and innovation incentives would, for instance, mean more advanced and efficient technology being developed at generation and grid level, thereby changing the structure of the generation market (e.g. towards efficient smaller-scale and decentralized generation) and the grid structure, which has to provide for the feeding-in of more decentralized generation, and consequently providing a higher degree of security of supply. See also Brunekreeft/Ehlers, nn. 8, 38; G Brunekreeft, 'DNO unbundling: the road to smart grids?', presentation at UNECOM workshop at TU Delft, 24 October 2008; R Künneke, 'Institutional reform and technological practice: The case of electricity', (2008) Industrial and Corporate Change 233.

303 Larouche, n. 239, pp. 28–30.

2. for the dominant undertaking, the cost of implementing a remedy including possible transaction costs and longer-term disincentives for innovation and investment;
3. for the administration imposing the remedy, the cost of imposing the remedy (gathering information, its analysis, monitoring and enforcement); and
4. for customers and the general public, the costs and benefits from the imposition of a remedy, (short-term) in the form of increased competition (with better choice and lower prices), but also longer-term disincentives for the dominant undertaking to innovate and invest.

According to this approach, for a remedy to be efficient, the following three conditions must be fulfilled cumulatively:

– no. 4 must be positive, i.e. there must be a net benefit to customers and the general public in the form of increased competition (outweighing longer-term disincentives);
– nos 2 and 3 together must be smaller than no. 4, i.e. the costs incurred by the dominant undertaking in connection with the implementation of the remedy and by the public authorities must be smaller than the benefits to customers and the general public; and
– nos 2 and 3 together have to be smaller than no. 1, i.e. the costs incurred by the dominant undertaking in connection to the implementation of the remedy and by the public authorities must be smaller than the advantage given to the competitor(s).

Not only must an effective remedy restore the desirable level of competition, which benefits both, the consumers and the general public as well as competitors. It is also important that any costs related to the implementation of an effective remedy and incurred by the dominant undertaking and the public authorities, especially in the long-term must be carefully taken into consideration in the course of establishing the efficiency of an effective remedy.[304]

304 Similar Larouche, *ibid.*

EC competition policy strives for increased consumer welfare[305]; thus, an efficient remedy has to be (at the least) consumer welfare enhancing.[306] In case of a proposed vertical separation, such a desired result can only be achieved if the negative effects on the dominant firm and the market in which such a firm is active are duly considered: loss of economies of scale and scope, increased transaction costs[307], risks of double marginalization[308], to name but a few. Since these negative effects are extremely difficult to determine, structural solutions to competition problems have so far been avoided in favour of behavioural remedies.[309]

The evaluation as to whether an effective remedy is also efficient also requires assessing the future performance of the proposed remedy.[310] In the case of divestiture, which would create a new competitor in the up- and/or downstream market (after the structural separation of the network *infra*structure), its performance and the performance of the restructured market have to be taken

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305 See n. 114. While not disputing the consumer welfare approach in this work, it might however be indicated that this approach in focussing on the welfare of consumers in particular in terms of a decrease in prices necessarily neglects the produces side where, for instance, transaction and investment costs go up, which in the long term have to be paid for by society. If society pays more for consumer welfare enhancing measures in the long term that it gains form such measures in the short term, the overall balance is negative for society; the consumer welfare approach is then not economically efficient. Thus, a *social* cost and benefit analysis (SCBA) by analysing the effects of a measure on society as a whole also takes its cost element into account, see Brunekreeft's SCBA outlined in the text accompanying nn. 350 *et seq.* and, in greater detail in the text accompanying nn. 1233 *et seq.*

306 See also Motta, n. 54, p. 18.

307 For the definitions of economices of scale and scope, see Motta, n. 54, p. 2 (n. 3), and Whish, n. 122, pp. 8–9. See also P Joskow, 'Transaction Cost Economics, Antitrust Rules and Remedies', (2002) JLEO 95.

308 But see Pollitt, n. 321 and accompanying text, who plays this particular risk down against the background of regulation of energy network access charges.

309 Geradin/O'Donoghue, n. 209, p. 17.

310 Competition Commissioner Kroes emphasizes that "when it comes to fundamentally restructuring the market, both competition law and regulation have to step into action" (see Introduction). Further the Director General of the European Commission's Directorate General Competition Policy, Lowe, jointly with other Commission officials has tried in Lowe/Pucinskaite/Webster/Lindberg, n. 12, to make the general case for ownership unbundling. As a consequence, although the discussion whether an effective remedy is also efficient takes place in the competition law enforcement context here, which is primarily concerned with individual undertakings, such evaluation appears to follow the same patterns of reasoning as the evaluation of the proportionality of sector-wide ownership unbundling introduced by sector-specific regulation in the context of its fundamental rights compliance. It also reflects the attitude of the Commission to also have quasi-regulatory functions as the guardian of the EC Treaty, see already n. 223. The preference towards ownership unbundling as competition law enforcement tool also blurs the distinction of principle between competition law enforcement (through the executive) and sector-specific regulation (through the legislature), according to which competition law can only alter the structure of the individual undertakings concerned and not a whole industry.

into consideration when deciding whether an effective remedy is also efficient. It is also likely that the dominant firm whose abusive conduct has been remedied will try to circumvent the remedy (whether structural or behavioural).[311]

Such an evaluation has yet to be undertaken by the Commission; in particular the economic evidence, which "shows that ownership unbundling is the most effective means to ensure choice for energy users and encourage investment,"[312] has yet to be tabled.[313] In this respect, the regulatory impact assessment delivered in support of its proposals seems not only to be highly superficial for this purpose but also inaccurate and based on misinformed case studies[314]; in particular the alleged success of the liberalization of the British gas sector is misleading.[315]

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311 Joskow, n. 307, makes the criticism that so far there have been no studies on the effects of divesture remedies, looking into the costs divested entities face, the competitive viability of a divested asset and the final effect such intervention has on the performance of competition. Joskow emphasizes the difference between voluntary divestitures proposed by firms during a merger control scenario, and divestitures as a remedy for anticompetitive behaviour of dominant firms. Voluntary divestitures can already have suffered from strategic behaviour of the firm obliged to divest, as a result of which bahviour there might be an early exit from the market of the newly created competitor, or collusive behaviour of the established competitors in the market. But this scenario might, according to Joskow, *ibid*., p. 115, be even more difficult to handle in structural remedy cases in the context of ex-post intervention because competition authorities are usually not in a position to adopt effective divestiture remedies as they usually lack a sophisticated "understanding of the consequences of alternative governance arrangements for divested assets." A study by the U.S. Federal Trade Commission on divestiture in merger remedies seems to draw similar conclusions, see Staff of the Bureau of Competition of the (U.S.) Federal Trade Commission, 'A Study of the Commission's Divestiture Process', 1999. See also M Motta, M Polo, H Vasconcelos, 'Merger Remedies in the European Union', in F Lévêque, H Shelanski (eds), *Merger Remedies in American and European Union Competition Law*, 2002, p. 106, who also seem sceptical as regards the adoption of structural remedies ex post. They suggest that the decision to impose structural remedies should be measured against the risk of creating single or joint firm dominance after the implementation of the divesture remedy.

312 European Commission, n. 10, p. 12, and n. 3, p. 12.

313 See, for instance, the chairman of the German Monopolies Commission, Haucap, n. 37, pp. 301 *et seq*.

314 See, for instance, the letter to A Piebalgs, Commissioner for Energy, by A Niebler, the chairwoman of the European Parliament's Committee on Industry, Research and Energy, Ref.: D(2007)72912, 22 November 2007, requesting further analysis on the 3rd energy package impact assessment, and the response by A Piebalgs of 11 December 2007, Ref.: D/(2007) 1462. See also the critique of S Thomas, 'A critique of the European Commission's evidence of the need for ownership unbundling of energy networks', PSIRU, University of Greenwich, London, July 2007, in particular with respect to Italy, Spain, Portugal, the Netherlands and the UK; G Brunekreeft, 'Ownership Unbundling auf Energiemärkten – eine Soziale-Kosten-Nutzen-Analyse der ÜNB-Entflechtung in Deutschland', presentation at Seminar FinPum, Universität Wien, 16 April 2008; SERIS, n. 38 (see, in greater detail, Part 2 Chapter 5 on Great Britain); see also Pielow, n. 11.

315 See Wright, n. 314, and Thomas, *ibid.* and n. 25. Lowe/Pucinskaite/Webster/Lindberg, n. 12, refer to gas network unbundling in Britain as evidence. They, for instance, identify a price reduction of 50 per cent in network charges since 1990 and high levels of investment after

What is more, contrary to the claim of the Commission in its *Impact Assessment* (RIA)[316], ownership unbundling of energy transmission networks seems not to be conducive to the reduction of the concentration in the European electricity generation and gas wholesale markets.[317] On the contrary, what can be observed, for instance, in the UK is that ownership unbundling will not in itself prevent concentration in wholesale and retail activities and vertical integration of energy retail with gas wholesale and electricity generation.[318] Even worse, there is no apparent mechanism of the European Commission to remedy the increasing vertical foreclosure in European energy markets.[319] The Commission even seems to accept this when stating in its RIA that "in an integrated market, external suppliers would be more likely to be faced with a smaller number of large and powerful EU-wide energy companies rather than 27 small national ones. These companies would have the financial strength to negotiate with external suppliers without needing to own the network, represent a very large portfolio of customers, have access to a wider range of alternative resources (LNG, North Sea gas etc.) [and] be more efficient and commercially focused than […] national incumbents."[320]

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unbundling. As Wright and Thomas (July 2007), *ibid.*, show, however, this evidence is seriously flawed. What is more, they do not seem to be clear about the criterion for judging the reforms, i.e. whether this is price reductions or increases in the level of investment. These two criteria tend to be mutually exclusive. Price reductions are likely to be possible only if investment levels are low, while large investment programmes must be paid for by consumers, tending to increase prices. See in greater detail, Thomas (July 2007), *ibid.*

316 N. 15.

317 This is shown by Thomas (November 2007), n. 315, para. 4.3.2. at the examples of Italy and Great Britain.

318 See NERA Economic Consultants and Thomas, nn. 1228, 1229 and accompanying text. See also The Brattle Group, n. 1212, as regards Scottish generation.

319 The use of the merger clearance regime according to the Merger Regulation, n. 19, by the Commission has not lead to bringing this process to a halt. For an in-depth analysis of energy mergers in the EU in recent years, see Hancher/deVlam, n. 159, and Hancher, n. 223. Vertical foreclosure, by the way, also occurred in the much smaller energy market of New Zealand after ownership unbundling was imposed on the industry, see P Nillesen, M Pollitt, 'An economic analysis of the ownership unbundling of electricity distribution in New Zealand', PriceWaterhouseCoopers and Electricity Policy Research Group, University of Cambridge, 2006; PriceWaterhouseCoopers, 'An economic analysis of the ownership unbundling of electricity distribution in New Zealand', commissioned by Essent N.V., 16 March 2006; P Nillesen, M Pollitt, R Sitompoel, 'Eigendomssplitsing in Nieuw Zealand', (2006) Economisch Statistische Berichten (ESB) 533. In New Zealand, the first and only country so far, which has forced unbundling of the distribution networks onto its energy sector, the development of competition has failed. After the separation of the retail businesses from the distribution networks, most of these businesses became vertically integrated in the five large generators and retail competition stopped. This process quickly foreclosed any subsequent retail entry. See also E Ehlers, 'Book Review: M. Roggenkamp, U. Hammer (eds.), *European Energy Law Report III*, Energy & Law, Volume 4, Intersentia, Antwerp, Oxford, 2006', (2007) JENRL 190; Brunekreeft/Ehlers, nn. 8, 38.

320 *Impact Assessment*, n. 15, p. 40.

In addition to the failure by the Commission to actually table economic evidence, the pros and cons of ownership unbundling of vertically integrated energy networks in the energy supply industry are highly controversial amongst economists. Theoretically or qualitatively[321], ownership unbundling affects competition in that the scope for discrimination against non-integrated rivals should be reduced. On the other hand, ownership unbundling might facilitate further mergers in the electricity generation market as sales of vertically unbundled transmission assets provide financial resources for horizontal integration. It is further said that in terms of ease and effectiveness of regulation, ownership unbundling would improve cost (and other types of) transparency in network and competitive businesses. However, it may also increase the requirement for regulatory oversight of transactions between unbundled stages of production. Ownership unbundling may facilitate privatization of the competitive and network businesses due to a greater sustainability of the unbundled market structure (and hence reduced regulatory risk). On the other hand, privatization of the networks might be delayed if they are kept in public ownership while generation and retail assets are privatized.[322] Ownership unbundling may further improve the focus of the transmission business on supply security and incentivize improved information flows. On the other hand, information problems between electricity generators or gas producers and shippers and transmitters may be created in the absence of investment into enhanced information systems. Ownership unbundling may also reduce transaction costs by facilitating the creation of more efficient price signals. This, however, may be countered by an increase in costs if new IT systems are needed

321 The following paragraph summarizes the concise elaborations of Pollitt, EPRG 0714, n. 37, pp. 7–10, which are themselves based on Mulder/Shestalova/Lijesen, n. 37 (balancing the economic arguments without relying on empirical evidence), M Mulder, V Shestalova, 'Costs and benefits of vertical separation of the energy distribution industry: the Dutch case', (2006) CRNI 197, Centraal Planbureau, 'Kwantitatieve verkenning welfvaartseffecten splitsing nenergiebedrijven', CPB Notitie, Den Haag, 20 March 2006, and Baarsma/de Nooij, n. 38 (balancing the economic arguments in reply to CPB and also rendering a social cost and benefit analysis based on several counterfactual scenarios and empirical evidence) who, contrary to *Pollitt*, however, come to ambiguous (Mulder *et al.* (CPB)) and negative results (Baarsma *et al.* (SEO)) in terms of welfare effects, albeit with respect to the Dutch market where, on the one hand, unbundling of distribution networks is at stake, and, on the other, most of the energy networks are owned by the State or its subdivisions, see further Part 2 Chapter 6 on the Netherlands.

322 In such a case ownership unbundling and privatization occur where competition is already in place, which might be different from ownership unbundling at the time of liberalization. This is because there are fixed cost elements (not least in political time) to restructuring of assets, the establishment of regulatory structures and the introduction of competition. Therefore ownership unbundling is likely to be cheaper when other restructurings are taking place and/or when initial ownership structures are cheaper to change with fewer implications for fundamental rights protection (i.e. a scenario involving initial state ownership of an integrated company, rather than private ownership). See Pollitt, EPRG 0714, p. 6.

to coordinate transmission and other separated (competitive) segments. There may also be significant power contract renegotiation costs, which if with foreign parties may involve substantial wealth transfers and lower national social welfare. As regards the cost of capital and investment, the overall cost may decline if transmission businesses can get access to cheaper capital and if there is increased ease of integration of generation and retail. In an efficient capital market separation should lead to efficient cost of capital for each business. The cost of capital may, on the other hand increase and investment be reduced if the size of firms falls, or if regulatory risk is increased due to increased (and inefficient) regulatory oversight of investment decisions. Ownership unbundling may also enable a clearer focus on the part of the separated energy supply businesses. The management of both, the networks and the competitive businesses of the former vertically integrated energy supply undertaking, may be subject to clearer incentives to improve their respective businesses. However, there might also be a loss of synergies or so-called vertical economies, due to a lack of knowledge of how the separated energy supply businesses operate. Double-marginalization should not become a problem when multipart-tariffs are applied. If, however, such tariffs are not applied in a fully efficient manner, the occurrence of double marginalization might be the consequence.[323] And because the sale of assets (one way or the other) as a result of ownership unbundling makes takeovers more efficient, foreign (and domestic) merger activity within the European Union is likely to rise. Undesirable takeovers of strategic assets may, however, only be prevented on the basis of a competition policy tailored to such market activity.[324] Ownership unbundling could also reduce the risk of arbitrary government intervention in terms of further major reforms for some time. However, ownership unbundling may also increase the likelihood of government interference in the operation of the network companies if these are retained in state ownership.

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323 See Haucap, n. 38, p. 303: Since transmission charges are not usually based in incremental cost, but include a mark-up to cover fixed and common costs, a second mark-up will be added at the retail and/or generation stage if these markets are not perfectly competitive. In the end, vertical separation may lead to higher prices than vertical integration, a tendency, which has been shown to be real in the European Union by a recent study of AT Kearney, 'Ownership Unbundling – Der richtige Weg für mehr Wettbewerb? – Zusammenfassung der Studienergebnisse', Berlin, January 2008, which compares, amongst other parameters, the development of electricity prices and electricity network charges of several Member States with different degrees of unbundling implemented in their respective electricity supply sector.

324 In this regard, see the third country ("Gazprom") clause in the Commission proposals for Energy Directives (n. 15) and the draft Energy Directives (n. 33), which requires for such a strategic sale to proceed that the purchaser's home market is liberalized to an extent similar to the EU market.

According to *Pollitt*, one of the academic proponents of ownership unbundling in the energy supply industry, in theory the benefits of this form of unbundling seem to outweigh its cost[325]: Ownership unbundling was likely to improve competition, ease regulation, facilitate privatization, lead to synergies, make foreign takeovers more likely and reduces the risk of arbitrary government intervention. He considers the counter-arguments outlined before as weak, referring to economic "school book" reasoning as followed by the European Commission for example that the ownership of physical transmission rights (under vertical integration) increased the ability of generators to exercise market power through withholding transmission capacity. The potential risk of higher cost of capital and stagnating investment levels is rebutted by contending that there seemed to be little technical reason why focus would not lead to improvements.

On the other hand, *Pollitt* also accepts that the transaction costs of ownership unbundling can be considerable.[326] He further concedes that ownership unbundling may indeed require stronger regulation (causing the regulatory burden to increase significantly) than under vertical integration (including legal unbundling) because more information asymmetries would occur than before

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325 Or, with respect to the cost of capital and investment volumes, at least not clearly disadvantageous. In his overview of the economic benefits and costs of ownership unbundling, however, *Pollitt's* weighing of the benefits and costs appears to be rather superficial. With regard to the case studies he refers to and explains, some do not seems to fit the European case because they involve continuing public ownership in the sector, and in others he comes to wrong conclusions (for instance when qualifying the New Zealand experience as successful) or contradicts himself when qualifying the regulation requirements of legal unbundling in France; *Pollitt* also seems to be mistaken about the state of unbundling of the German market, which he qualifies as vertically integrated as opposed to the French market where he sees his model of legal unbundling realized. With respect to energy transmission, however, which is in the focus of his work, the German market is indeed fully legally unbundled, see further Part 2 Chapter 4 on Germany, which includes the holding of the network assets by the legally unbundled transmission network operators. This serious flaw in analysis, in particular with respect to the fact that Germany belongs to the biggest energy supply markets in the EU, appears to bias the conclusions in places. *Pollitt's* conviction about the success of regulation and unbundling of the GB market is to some extent relative when considering the serious criticism of energy supply liberalization in the UK as raised by Thomas and SERIS, n. 314. The special situation of the GB market with respect to the success of liberalization is also stressed by D Newbery, 'The relationship between regulation and competition policy for network utilities', presentation at conference "Advances in the Economics of Competition Law", Rome, 24 June 2005, p. 7. Reviewing econometric empirical evidence on the effects of ownership unbundling, *Pollitt* argues very tentatively and contradictory, which can, for instance, be seen at p. 17 where on the one hand he claims that unbundling leads to lower prices but, on the other hand, admits that this effect is difficult to model given the differences in underlying cost structures.

326 See, however, Baarsma/de Nooij, n. 38, showing empirically that such cost can indeed be substantial and even outweigh the claimed benefits of ownership unbundling. See also in the particular context of divestiture remedies, Joskow, n. 311.

between the undertakings involved in energy supply, and there would be more market based transactions between such undertakings. This may negatively affect the incentives to invest or operate the transmission system effectively, in the absence of skilful regulation. He further admits that separation would lead to different market interest rates for raising capital, which albeit important for financial efficiency would be likely to raise the cost of capital for new generation investments and hence reduce the volume of investment in generation. On the other hand, fully vertically integrated firms may require significant amounts of anti-trust monitoring and enforcement action if privately owned.[327] *Pollitt*[328] also observes that the main problem of forced separation is its unintended consequences, which are brought about by any structural reform of an industry.[329] Moreover, there seems to be no clear evidence that structural remedies generally bring about social welfare improvements.[330] Any major policy induced change to market structure may require significant vigilance on the part of anti-trust

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327 Pollitt, EPRG 0714, n. 37, p. 26.

328 Pollitt, EPRG 0714, n. 37, pp. 26–7.

329 This is particularly true with respect to whether restructuring by way of ownership unbundling is consistent with future technological developments, i.e. robust to the likely future evolution of the electricity and gas industries, see more generally in this respect, Künneke, n. 302, Pollitt, EPRG 0714, n. 37, pp. 27–8, and M Mulder, V Shestalova, G Zwart, 'Vertical Separation of the Dutch Energy Distribution Industry: an Economic Assessment of the Political Debate', Forum: Vertical Unbundling in the EU Electricity Sector, (2007) Intereconomics 305, argue that network expansions may become increasingly important because with increased cross border flows, increased demand for electricity from renewable energy sources on the system and increased future expansion requirements transmission increasingly competed with generation (in this regard, see Balmert/Brunekreeft/Gabriel, n. 47). They consider creating ownership unbundled transmission companies conducive to such development Mulder/Shestalova/Zwart, *ibid*., however, qualify this conclusion in that the overall welfare effect of ownership unbundling is ambiguous as long as small-scale generation does not play a major role, see also n. 321. If small-scale generation, however, gained importance, the largest *potential* positive effect of ownership unbundling could be achieved if applied to *distribution* networks, which would lead to increased competition in the wholesale energy market. See, however, Brunekreeft/Ehlers, nn. 8, 38, who show for distributed generation and distribution network ownership unbundling that such conclusions might not necessarily hold. As distributed generation becomes increasingly important and with it the smart configuration of distribution networks, the distinction between transmission and distribution will, however, become increasingly blurred, *cf.* Pollitt, (2007) Intereconomics, n. 37, p. 296. *Pollitt* also expresses the expectation that competition between generation and transmission may have the added benefit of improved information flow compared to the situation under vertical integration, in that one party (generation or transmission) will have an incentive to reveal accurate information that will benefit it, even if it is at the expense of the other. This effect, however, can already occur under legal and operational unbundling conditions, as has been confirmed by the German regulator Bundesnetzagentur (BNetzA) in its Monitoring Bericht (Monitoring Report) 2008, pp. 214–5.

330 R Crandall, C Whinston, 'Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence', (2003) 4 Journal of Economic Perspectives 3, for instance, struggle to find consumer benefits arising from structural remedies in the most celebrated anti-trust cases in the US (including Standard Oil, Alcoa and AT&T).

authorities as market forces (via mergers) seek to reconfigure the industry in the light of legal restrictions on ownership. Care should be taken that the additional cash generated by the sale of transmission assets is not used to finance reintegration by way of mergers between generation and retail leading to foreclosure at this side of the energy supply market.[331] Wholesale markets were of little use if retailers were buying their supplies from their wholesale divisions, which would, moreover, compromise the main justification for liberalization, which was to turn the wholesale activity from a monopoly to a competitive market.[332] Price signals would not be reliable enough for electricity and gas to be bought in significant quantities on the (visible) wholesale market and would certainly not be reliable enough to provide signals that would be the basis for investments.[333] Ensuring non-discriminatory access to the energy networks was simply an enabling measure to allow the wholesale and retail markets to function efficiently. If, for other reasons, the markets could not function efficiently, unbundling had little if any value.[334] However, the European Commission in its market analyses concentrated heavily on the integration of networks and wholesale/retail with little mention of integration of wholesale and retail.[335]

Haucap, the chairman of the German Monopolies Commission, however, finds considerable arguments against ownership unbundling[336]: even an unbundled network operator may have an incentive to discriminate between different

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331 Thomas, nn. 314 and 25.

332 Thomas, n. 314.

333 If the market is dominated by such companies, the liquidity of the visible wholesale markets will be negligible, as seems to the case in the UK where six integrated companies dominate the energy markets, see in greater detail Thomas (November 2007), n. 315, contradicting S Dow, 'Energy Law in the United Kingdom', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, chapter 15, nos 15.217, 15.315. The UK energy markets seem to get more concentrated and dominated by integrated generation and retail undertakings, see already nn. 317 and 319 and accompanying text.

334 Thomas (July 2007), n. 314. The barriers to entry for new retail and gas wholesale/electricity generation companies would become insurmountable. If there is no liquid wholesale market, a new generator or gas importer would have nowhere to sell its product and a new retailer would have no market in which to buy supplies, see Thomas (November 2007), n. 315. Exactly this seemed to have happened in New Zealand after the imposition of ownership unbundling on its energy supply sector. On New Zealand, see n. 319.

335 This is in spite of the Commission acknowledging the failure of the wholesale markets when it finds in its Sector Inquiry, n. 3, p. 6, that there is a chronic lack of liquidity, both in electricity and gas wholesale markets. However, it proposes no remedies for dealing with what it had acknowledged in its Preliminary Report of February 2006, n. 41, as one of the main causes of this lack of liquidity, corporate integration of wholesale and retail activities. It might be recalled that one of the major findings of the Commission in the Preliminary Report was the problems created by vertical foreclosure (see also n. 186) in both, the electricity and gas markets. The Commission representatives Lowe/Pucinskaite/Webster/Lindberg, n. 12, also ignore the issue of integration of wholesale and retail. See further Thomas, nn. 314 and 25.

336 N. 38, p. 303.

customers, just as any monopolist or oligopolist has an incentive to engage in price discrimination. There was no reason to believe that a vertically separated network monopolist would not engage in price or non-price discrimination if this was possible. Whether such discrimination was possible depended on the degree of regulatory supervision and the contractual arrangements between the various energy supply undertakings, which may engage in, as he calls them, "side payments" to re-establish the vertical integration through the "back door". Consequently, even vertically separate networks would need regulatory supervision as the potential to abuse market power would remain. While it was clear that the price levels needed regulation, the incentives to discriminate would not be eliminated either, which contrasts with the repeated claims by the Commission. Even a single-product monopolist usually has an incentive to engage in price or non-price discrimination.[337]

As regards the incentive of the network operator to invest, in particular in network reliability, such incentive would likely be negatively affected as a result of vertical separation. This is because an integrated network operator has a much greater incentive to ensure that the network is reliable. In the case of a blackout, the vertically integrated energy supply undertaking would not only forego transmission revenues, but also the revenues from electricity, which cannot be sold during the blackout. Additionally, the specificity of network investments further reduced investment incentives if companies were vertically separated. In fact, investment specificity had been the key argument of transaction cost economics in favour of vertical integration.[338] Should double marginalization occur[339], this also reduces the investment incentives for a separated network operator because it would reduce its profits from additional investment.[340] Further, it had been shown that it is in fact legal unbundling, which may yield the best investment incentives when compared to full integration and full ownership unbundling.[341]

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337 Similar C Müller, 'Eine preistheoretische Betrachtung des Ownership Unbundling', (2006) 1/2 et 34, 36.

338 See Haucap, n. 37, p. 304. See also O Williamson, *The Economic Institutions of Capitalism*, 1985; S Grossmann, O Hart, 'Vertical and Lateral Integration', (1986) Journal of Political Economy 619.

339 See n. 323 and accompanying text.

340 Under certain circumstances, the separate network operator can, however, also engage in over-investment, see The Brattle Group, n. 191, and Part 2 Chapter 5 on Great Britain.

341 See Haucap, n. 37, p. 304. F Höffler, S Kranz, 'Legal Unbundling: A Golden Mean between Vertical Integration and Vertical Separation?', Working Paper, WHU Otto Beisheim School of Management, 2007; in this regard also H Cremer, J Cremer, P de Donder, 'Legal Vs Ownership Unbundling in Network Industries', CEPR Working Paper Series, No. 5767, 2006.

Lastly, *Haucap* rightly refers to the likely long legal battles, which ownership unbundling or divestiture with the requirement of a forced sale of either networks or the non-network assets and activities would entail. In the meantime, there would be considerable legal uncertainty resulting in negative impacts on investment incentives for both, generation and network operators.[342]

According to *Haucap*, the case for ownership unbundling in gas was actually much weaker as gas can be more easily substituted for than electricity by a substantial number of (potential) customers, which decreases market power. As gas to a large extent comes from non-EU countries such as Russia, Norway and North-African countries, if their firms (such as Gazprom) had to unbundle from their networks within the EU, they would simply raise prices at the borders.[343]

The double marginalization problem would also be more likely to occur as these countries do not fall under EC jurisdiction (at least as far as gas production concerned). Thus, the vertical separation of gas production, transport and retail entails substantial problems in this regard, also because much larger parts of long-distance pipeline systems are outside EC jurisdiction, dedicated to particular gas fields, which makes them specific investments. What also needs to be considered is that ownership unbundling would substantially reduce the gas undertakings' incentive to invest in electricity generation within the EU.

Instead of ownership separation or introducing "deep" ISOs, *Haucap* considers a whole package of remedies necessary to remedy what have rightly been shown by the Commission to be competition deficiencies hampering the development of an internal market for energy supply: the need for a significant reduction of planning regulations for electricity generation and network expansions (including an acceleration of permission procedures, even against local resistance), a solid regulation of network connection, access and charges[344] and a stringent requirement for transmission network operators to use the revenues from the

342 Haucap, n. 37, p. 304, also notes with regard to "deep" Independent System Operators as for instance, proposed by the Commission, see further *infra*, similar issues would arise as outlined here in the context of ownership unbundling. Further, collusion might be facilitated. As a result, it can be said that both, ownership unbundling and "deep" ISOs are not efficient.

343 N. 37, p. 304. C Growitsch, G Müller, M Stronzik, 'Ownership Unbundling in der Gaswirtschaft – Theoretische Grundlagen und emprirische Evidenz', WIK-Diskussionsbeitrag Nr. 308, Mai 2008, also cannot see an economic justification for ownership unbundling in the gas sector.

344 See, for instance, the German regulation KraftNAV (Verordnung zur Regelung des Netzanschlusses von Anlagen zur Erzeugung von elektrischer Energie (Regulation concerning network connection of generation plant), 26 June 2007, BGBl. I, p. 1187), which alleviates the connection and access of new generation, and the introduction of incentive regulation there from 2009.

allocation of scarce interconnector capacities to increase such cross-border transmission capacities.[345]

When it comes to quantifying the costs and benefits based on empirical data, the economic justification of ownership unbundling appears to be even more doubtful as has recently been argued by *SEO*[346] and *Brunekreeft*.[347]

Brunekreeft has produced a *social* cost and benefit analysis of ownership unbundling of the electricity transmission networks in Germany, which, however, allows for more general conclusions to be drawn. He analyzes two intended effects of ownership unbundling in the form envisaged by the European Commission, namely the facilitation of investment into the expansion of the European energy transmission networks and the construction and expansion of interconnectors at the internal borders[348], and more favourable conditions for network access and stronger competition in up- (generation wholesale) and

345 Which would, however, not require ownership divestiture or unbundling but simply an amendment of Regulation 1228/2003, n. 219, deleting all other options for using such congestion charges. According to the President of the German regulatory agency Bundesnetzagentur BNetzA, Kurth, interconnector capacity seems actually to catch up, see M Kurth, 'Hearing on the third legislative energy package proposals of the European Commission', European Parliament, Committee on Industry, Research and Energy, Brussels, 31 January 2008. On interconnection projects in the UK and the Netherlands, see in the Part 2 Chapters 5 and 6 *infra*. Another central element of such a package is ever closer regional cooperation of regulatory agencies and transmission system operators, see in greater detail chapter 3 *infra*.

346 See Baarsma/de Nooij, n. 38, and Baarsma/de Nooij/Koster/van der Weijden, n. 115.

347 Brunekreeft, n. 9. Brunekreeft applies the so-called Residual Supply Index (RSI) model used by London Economics in its study for the European Commission, n. 12, in which it analyzes the market structure in six EU Member States.

348 It may be recalled that the "strategic investment withholding" argument (see Brunekreeft, EPRG, n. 9) claims that vertically integrated utilities have insufficient incentives to invest in interconnector capacity in order to hold off competition from abroad. Reversing the argument, it is said that unbundling would improve incentives to build interconnector capacity. One major issue, which this assumption neglects, however, is that even if all the incentives to invest are good actual investment may still be impeded by legal obstacles with respect to obtaining a building permission in good time, and factual obstacles in terms of local resistance; with respect to resolving legal obstacles, this is in the sole remit of the Member States, as are, in the same context, the legal condition of network connection of generation capacity. See in this regard the recent German regulation KraftNAV, n. 344.

downstream (retail) markets[349], which is supposed to contribute to decreased prices for energy consumers.[350]

Brunekreeft argues that the positive effect of ownership unbundling on investment into electricity generation[351] and interconnector capacity may be rather small; available generation capacity and the effects of ownership unbundling on such capacity actually determines the size of such capacity investment.[352] Under the favourable but debatable assumption that ownership unbundling can in principle have a generation and interconnector capacity acceleration effect (and thus a positive effect on competition), i.e. investment would become available faster than without unbundling, in practice such an acceleration effect is only likely to take place in times of low or even scarce generation capacity. If there is, however, adequate generation capacity, which falls into the remit of the Member States, unbundling does not seem to have such a capacity acceleration effect because investment will not be needed in the face of adequate generation capacity[353]; as a

349 For some more detail on these effects, see Part 2 Chapter 5 on Great Britain. It may be recalled that theory claims that unbundling increases competition. Unbundling is argued to have pro-competitive effects, which is one of the drivers of the debate. This effect may be direct by intensifying the competition among existing players, or indirect, by facilitating more or faster entry of third parties. More competition can result in lower prices and thereby benefit consumers, and can also increase cost pressure and thereby increase the sector productivity. But see, however, n. 311 and n. 326 and accompanying text as regards the long-term costs for society. See also n. 305.

350 See nn. 114 and 305. One of the most important determinants of competition and prices (in electricity wholesale markets) is the availability of generation capacity relative to peak load, i.e. when demand for electricity peaks. More and/or faster investment in generation and interconnector capacity would increase total available generation capacity and thereby intensify competition; interconnector capacity makes generation capacity in other Member States available. More available generation leads to more competition, which is reflected in the Residual Supply Index.

351 Based on the assumption that ownership unbundling might be more conducive because independent network operators have less of an interest to withhold generation capacity.

352 The size of interconnector capacity depends on the volume of electricity imports and exports, which can lead to more or less generation capacity and therefore to more or less competition.

353 This is also something, which the Commission should in principle know, see, for instance, the study by CESI *et al.*, 'TEN-ENERGY-Invest – Energy *Infra*structure Costs and Investments between 1996 and 2013 (medium-term) and further to 2023 (long-term) on the Trans-European Energy Network and its Connection to Neighbouring Regions with emphasis on investments in renewable energy sources and their integration into the Trans-European energy networks, including an Inventory of the Technical Status of the European Energy-Network for the Year 2003', TREN/04/ADM/S07.38533/ETU/B2-CESI, October 2005, no. 4.6.2.5., pp. 89 *et seq.*, 92, which was commissioned by the Commission and is available on the Commission's website. See further on this issue, J Hers, Ö Özdemir, 'A Nodal Pricing Analysis of the Future German Electricity Market', study of Bremer Energie Institut and ECN Amsterdam, 2009, and Ö Özdemir, J Hers, E Bartholomew Fischer, G Brunekreeft, B Hobbs, 'A Nodal Pricing Analysis of the Future German Electricity Market', proceedings of the 6th International Conference on the European Energy Market (EEM 09), Leuven, 27–29 May

consequence, the positive effect of ownership unbundling on interconnector capacity would be very small.[354]

To summarize, the size of the effects of ownership unbundling on interconnector capacity and competition critically depend on available generation capacity, which apart from the fact that interconnection makes more generation (from abroad) available[355], is a matter for the Member States to provide in a sufficient manner.[356] Only if Member States do not manage to provide adequate generation capacity[357], can the EU and thus the Commission as guardian of competition in the internal market consider measures to promote interconnection and generation adequacy. This, however, is a regulatory issue and not one of competition law enforcement because individually enforced ownership unbundling would not change the structure of the internal energy supply market or significantly enhance interconnection capacity.

III. CONCLUSIONS

As the European Commission in its capacity as competition authority would act as an organ of the executive, it only possesses a limited margin of appreciation (compared to the margin of appreciation of the legislature with respect to passing legislation) as regards the question whether and how to react to anticompetitive behaviour of vertically integrated energy supply undertakings. Because of the systemic (potential) conflict of vertical integration, ownership separation would likely be considered an appropriate means to restore the competitive process; however, such a step would not be necessary or proportionate because milder, and as has been explained here, equally effective means are available, in particular

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2009. On the efficient location of generation investment, Brunekreeft/Neuhoff/Newbery, n. 290.

354 The same is true for the effect of ownership unbundling on competition, which results from the size of its effect on interconnector capacity. *Brunekreeft* estimates the effects of ownership unbundling as small.

355 Article 176 of the Treaty on the Functioning of the European Union (TFEU), n. 300, explicitly provides for network interconnection to fall into the competence of the EU, see chapter 3.

356 According to the Article 175(2) EC, the energy mix and thus electricity generation falls into the sole remit of the Member States; but see also *infra*, chapter 3, with respect to the issue of security of energy supply in the context of unbundling measures in the European energy sector, more particularly Directive 2005/89/EC of 18 January 2006 concerning measures to safeguard security of electricity supply and *infra*structure investments, OJ 2006 L 33/22, 4.2.2006, and Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply, OJ 2004 L 127/92, 29.4.2004.

357 Which, at least for Germany, albeit that generation scarcity is projected, seems unlikely to happen. See BNetzA, n. 125, p. 61. See also, with respect to the fact that the adequate provision of generation capacity falls into the remit of the Member States, the elaborations in the context of the principle of subsidiarity in chapter 3 section VI *infra*.

if worked out and supervised in cooperation with the corresponding sector-specific (national) regulatory agencies.

The application of the principle of proportionality in the context of *ex post* competition law enforcement, in particular with regard to imposing structural remedies, places great emphasis on the protection of the fundamental economic rights of the dominant undertaking, in particular the structure or organization of its property. At the same time, the proportionality principle can be seen as preserving competitive market conditions by including an efficiency test for prospective remedies, which should include a social cost benefit analysis.[358]

According to the analysis of the costs and benefits of the structural remedy of ownership unbundling, a possible trade-off exists between its effectiveness and its efficiency. While the choice is obvious when two prospective remedies are equally effective but not equally efficient, it becomes complicated when a behavioural remedy does not appear to be as effective as a structural remedy, but where such a structural intervention would only remedy an abuse of a dominant position in the short-term and be expected to produce efficiency losses in the long-term.

It is claimed here that the Commission when facing such a dilemma is not allowed to impose such a structural remedy, as it would not be proportionate to do so. Rather, the adoption of an effective remedy, which also observes economic efficiency, even if it was more costly and took longer to restore competition, would be the way forward.[359]

It has been suggested here that in a setting of network *infra*structure monopolies, the application of the "essential facilities" doctrine, i.e. an obligation to grant TPA to network facilities, as a behavioural remedy with structural implications

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358 According to Sullivan, n. 239, pp. 377 *et seq.*, an antitrust remedy is in line with the principle of proportionality if it ends the offending conduct, prevents its recurrence and restores the competitive conditions in the market.

359 W Comanor, 'The problem of remedy in monopolization cases: the *Microsoft* case as an example', (2001) Antitrust Bulletin (Spring 2001) 115, 132, distinguishes two coexisting and co-applied approaches to the determination of a remedy, namely a "legal" approach focussing on the violation of competition rules by a dominant firm and its consequences, and a so-called "regulatory" approach taking market and consumer welfare enhancing effects into account when adopting a remedy. He claims that an excessive focus on efficiency considerations could lead to an ineffective remedy. It is contested though that imposing a less effective remedy, which is sufficiently efficient, is not only proportionate in the short run. It does also not give rise to changes in market conditions in the long run which are already known to be harmful to competition (as a result of knowing the remedy's efficiency). This contrasts with choosing a more effective but less efficient remedy, which alters market condition to the positive in the short run but for which it is already clear at the outset that it will cause competition problems in the long-term.

on related markets might prove to be equally as effective as an imposed divestiture but less problematic in terms of the efficiency of the remedy (and the impact on the fundamental economic rights of the dominant undertaking).[360] Given the fact that competition authorities are well capable of tackling TPA to energy supply networks under competition law *ex post* in individual cases (possibly in close cooperation with national regulators, which can impose more detailed access rules), imposed divestiture seems not to be proportionate according to the (remedial) proportionality test as required under Regulation 1/2003.

When weighing the economic arguments pro and contra ownership separation of the energy (transmission) networks from vertically integrated energy supply undertakings (here by way of competition law enforcement), its benefits are qualitatively diffuse or ambiguous. Quantitatively or empirically, however, the benefits of forced divestiture in a liberalized market setting appear highly questionable.

As has been shown in the context of economic reasoning pro and contra ownership separation, sufficient generation is actually the problem in the energy supply industry; moreover, more interconnection investment or expansions of the energy transmission networks only happen if they are economically justified.[361] The current exemptions for energy supply network investment[362], which competes with generation, seems to be the way forward as regards attracting more network investment as is the obligation to reinvest all revenues received from interconnector congestion charges into the expansion of such interconnectors. Further, the sector-specific regulators and competition authorities' sanctioning of (network) capacity hoarding also appears conducive to reduce anti-competitive behaviour of vertically integrated energy supply undertakings with respect to their network operations.

Further, it should be noted that assuming for the sake of argument that the Commission would legitimately exercise its power under competition law to impose structural remedies on individual vertically integrated energy supply undertakings, the use of this *ex post* power might lead to competitive malformations in the sector (as might actually the *ex ante* use of merger remedies to restructure the sector). This is because competition law is only enforced in individual cases of anti-competitive behaviour (or, in merger cases, to prevent such occurrences in the future). In an industry characterized by incumbent firms

360 See also Bergman, n. 280, p. 434.

361 Which is obviously different from cases where existing networks have to be maintained or reinforced in order to fulfil the network operators obligations to ensure network reliability and security under the current regulatory framework.

362 See in greater detail in chapter 3 *infra*.

in the various Member States, and taking into account the incentives to exercise their market power in an anti-competitive way as outlined in the previous chapter, it can easily be appreciated that incumbents tend to behave anti-competitively across the board. On the other hand, not every instance of anti-competitive behaviour is (easily) detected. Given that National Competition Authorities are likely to pursue different competition law enforcement practices and further to the decentralization of competition law enforcement in the European Union away from the Commission to the National Competition Authorities, applying structural remedies in individual cases is likely to lead to competitive disadvantages for the energy supply undertakings concerned compared to their peers, which were lucky enough or more cautious not be detected and subsequently subjected to such structural remedies.

In this context, it should also be noted that the creation of a level playing field, which is one of the goals of European competition policy, would be seriously undermined if the European Commission exercised its power to order structural *ex post* measures. The prevention of cross-subsidization by sector-specific regulation, which is not applied coherently to the energy sector because it is only targeting sector-internal cross-subsidization and only with respect to vertically integrated energy supply undertakings but not those companies, which cross-subsidise from sources other than those situated in the energy supply sector, is also contributing to "unlevelling" (i.e. reducing the levelness of) the playing field, as do, by the way, the divergent licensing and authorization requirements (which also vary in terms of the time delay before they are granted), which impose different burdens upon competing operators in different Member States.

Finally, competition laws enforced TPA as referred to above as well as legal and operational unbundling and the 2003 Energy Directives as implemented by the Member States (possibly in combination with tightening the regulatory requirements of these Directives) appear to be sufficient means to remedy competition concerns.[363] Moreover, as has been demonstrated in the E.ON and RWE cases[364], the threat of high fines imposed on returns from energy network operations, which are moreover already regulated, not only contributes to the resolution of competitive concerns but also has precential value, which increases the pressure on the industry to comply with competition law.[365]

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363 As to the latter, see chapter 3 *infra*.

364 Which have undertaken to sell, respectively, their electricity and gas transmission networks. See n. 252.

365 Sector-specific regulation and corresponding enforcement powers of regulatory agencies are obviously also conducive to convince the industry not to behave anti-competitively as is private competition law enforcement in ordinary courts.

CHAPTER 3
UNBUNDLING AS PART OF SECTOR-SPECIFIC REGULATION

The rationale behind economic regulation of EC energy supply networks, which consists of competition law enforcement on the one hand and sector-specific regulation on the other, has been shown in chapter 1 of this Part 1. Now, after discussing certain aspects of competition law enforcement with respect to the European Commission's competence to restructure European energy supply, the legislative competence of the EU to introduce further unbundling measures, in particular in the form envisaged by the Commission in September 2007 (as outlined in the Introduction) is the subject of the discussion to follow in this chapter 3.[366]

I. INTRODUCTION

Before analysing whether the EU possesses a competence to impose further unbundling measures on the European energy supply industry, section II briefly explores why it is just this industry, which is subjected to such strict unbundling requirements. Section III then outlines the evolution and latest status of EC energy supply policy and (proposed) legislation to the extent relevant here, with an emphasis on the institutional side of sector-specific energy supply network regulation.

Section IV deals briefly with the question of the competence of the European Union to become active in energy sector-specific regulation.[367] Reference will also be made to the first time introduction of an energy chapter in the Lisbon

366 Fundamental rights aspects of exercising any such competence are discussed *infra* in Part 2 Chapter 7.

367 For rather extensive discussions about whether Article 95 EC and/or other provisions of the EC Treaty can or cannot serve as a basis for energy sector-specific regulation, see U Hüffer, K Ipsen, P Tettinger, *Die Transitrichtlinien für Gas und Elektrizität*, Bochumer Beiträge zum Berg- und Energierecht, Band 14, 1991, R Scholz, S Langer, *Europäischer Binnenmarkt und Energiepolitik*, Schriften zum europäischen Recht, Band 13, 1992, H Jarass, *Europäisches Energierecht*, Schriften zum europäischen Recht, Band 23, 1996, Baur/Lückenbach, n. 96, and Baur/Pritschke/Klauer, n. 86.

Treaty (which is not yet in force).[368] More important in this context and on the assumption that such a competence exists, is, however, whether the European Union actually is allowed to exercise this competence with respect to introducing further unbundling measures. Section V thus elaborates on Article 295 EC[369] and the question of whether this can be seen as an absolute bar on the European Union engaging in further unbundling of energy supply networks. Some brief elaborations will follow with respect to Article 175 EC[370] and Article 194(2) Lisbon Treaty to see whether these provisions can be regarded as another absolute bar on the European Union introducing further energy supply network unbundling.

The competence conferred by Article 95 EC serves to assist in the achievement of the goals set out in Article 14 EC, and thus the fundamental freedoms of the internal market.[371] It thus is to be asked whether compulsory ownership unbundling or the introduction of ISOs would override these freedoms. This is because if these two alternative unbundling measures entered into force unaltered and without further less rigid alternative unbundling measures[372], the

368 N. 300. The entering-into-force of the Lisbon Traty is pending a second referendum inthe Republic of Ireland in autumn 2009 and the approval by the respective heads of State of the ratifications in Germany (pending a ruling of the BVerfG, the Czech Republic and Poland (pending the outcome of the said Irish referendum). It is likely that the Lisbon Treaty enters into force at the beginning of 2010. See Financial Times, 'Czech clear way for Lisbon treaty', 6 May 2009, and Spiegel, 'Tschechien stimmt für EU-Reform', 6 May 2009.

369 The English version says that "[t]his Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.".

370 As part of Title XIX "Environment" of the EC Treaty, Article 175(2)(c) says that "[…] without prejudice to Article 95, the Council, acting unanimously on a proposal from the Commission […] shall adopt: […] measures significantly affecting a Member State's choice between different energy sources and the general structure of its energy supply."

371 See ECJ, C-376/98 – *Germany* v *European Parliament & Council* (*Tobacco Advertising Directive)*, (2000) ECR I-8419, nos 83 *et seq*.

372 On 9 and 10 October 2008, the EU Energy Council agreed the coexistence on the internal energy market of three different unbundling models for production and supply activities, on the one hand, and energy transmission activities on the other. The Council (and the European Parliament on 22 April 2009 with amendments in detail) approved a third solution (ITO) (additional to what has been proposed by the Commission in September 2007) whereby independent transmission network operators would be set up with a view to effective unbundling. This option would enable companies to retain ownership of transmission networks provided that the networks were operated by an independent transmission network operator and that additional assurances were given. As regards this third option, see already nn. 31, 33 and 95 of the Introduction and accompanying text. Undertakings engaging in the production or supply of gas or electricity will, however, be prohibited from exercising control over or operating transmission networks in Member States that have opted for full unbundling. See Council of the European Union, 'Conclusions C/08/276 of 2895th Council meeting Transport, Telecommunications and Energy', Press Release 13649/08, Luxembourg, 9 and 10 October 2008, p. 18, and Recital 16, Article 9(12) of both the Electricity and Gas Directive proposals as approved on those dates, according to which, in an unbundled ownership

Commission in its 2007 proposals further intends to ensure that vertically integrated energy supply undertakings in the EU would have to either give up all of their (shareholdings in) energy supply networks[373] or supply/production activities *all throughout* the EU (if ownership unbundling was enforced EU-wide). Or, in the event that a Member State chose to introduce ISOs, vertically integrated transmission network owners situated in such a Member State[374] would not only *not* be allowed to operate transmission networks *anywhere else* in the EU; as vertically integrated energy supply undertakings pursue production or supply activities, they would equally not be allowed to own and pursue such activities in Member States where ownership unbundling has been enforced instead of ISOs.[375] Similarly to ownership unbundling, this would mean that existing network activities or the other energy supply activities would have to be sold.[376]

Thus, section V(4) deals with the question of whether the Commission proposals infringe the free movement of capital according to Article 56(1) EC[377], which can be regarded as a relative bar to exercising the competence of Article 95 EC because it allows for exceptions if legislative measures are proportionate.[378]

Before chapter 3 concludes, section VI will discuss the question of whether further unbundling measures as envisaged with the Commission proposals of

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scenario, vertically integrated gas supply undertakings are also not allowed to control electricity transmission networks and their operations and vice versa.

373 And, obviously, any network operations.

374 With transmission network ownership being legally unbundled, see Article 10a of the 2007 Commission proposals for Energy Directives, n. 15, and the operation of the network pursued by an Independent System Operator.

375 Although Recitals 10 and 11 of the proposals refer to system operators only, Article 8(1) and (2) and Article 10(2)(a) and Article 10a of the 2007 Commission proposal for an Electricity Directive in conjunction with p. 7 (1st para.) of the proposals' *Explanatory Memorandum*, n. 15, for instance, might be read in this way. This conclusion seems also be supported by the proposals' referral to the EU wide applied term of control, see n. 19. It is not clear from these proposals whether vertically integrated electricity supply undertakings would be allowed to control gas supply activities or *vice versa*. As regards the position under the draft Electricity and Gas Directives as approved by the European Parliament on 22 April 2009, see n. 569.

376 For instance, if the ISO model was introduced in Germany and ownership unbundling according to the proposals in the UK, German vertically integrated energy supply undertakings such as E.ON would have to give up either their supply and generation activities in England and Wales or their networks in Germany. To a less extreme extent, this is now the explicit position of the Council of Energy Ministers, see n. 372 and in greater detail *infra* where issues of Article 56 EC are discussed. See also n. 24.

377 The fundamental freedoms do not only bind the Member States but also, as can be inferred from, inter alia, Articles 3(1), 7(1) and 249(1) EC, the community legislature, see Schroeder in Streinz, EUV/EGV, 2003, Article 28 EGV, no. 29, and thus any new legislation on the basis of the agreement reached by the Council of Energy Ministers on 9 and 10 October 2008 or the approval of the European Parliament on 22 April 2009, see n. 372.

378 See ECJ, C-51/93 – *Meyhui* v *Schott Zwiesel Glaswerke*, (1994) ECR I-3879, nos 20 *et seq.*; ECJ, C-114/96 – *Kieffer & Thill*, (1997) ECR I-3629, nos 31 *et seq.*

September 2007 obey the principles of subsidiarity and proportionality in Articles 5(2) and 5(3) EC.

II. LEGAL (OWNERSHIP) UNBUNDLING ONLY IN ENERGY SUPPLY NETWORK INDUSTRY

Structural separation in the form of legal or corporate unbundling[379] of non-competitive *infra*structure network activities from competitive up- or downstream activities as required of the European energy (electricity and gas) industry has not (yet) been applied in the European postal services, telecommunications and rail industries[380], at least not as rigidly.[381]

One of the reasons why more rigid forms of structural separation like legal or ownership unbundling have not been tried in the European rail, postal or telecommunications industries appears to be political resistance. Other reasons comprise the technical structure of the industry in question, potential restructuring costs, the observance of the proportionality principle in the restructuring measures deemed to be necessary to promote competition as well as public policy issues such as securing public and universal service obligations.[382]

In the railway sector the EU has chosen to approach liberalization in three stages. The first step was undertaken with Directive 91/440 providing for accounting separation between *infra*structure and operations.[383] A second step, the so called First Railway Package entered into force on 15 March 2003, opening up the trans-

379 See Introduction.

380 It may be recalled that the European Council under the Portuguese presidency in its Lisbon Strategy in March 2000 encouraged the European Commission and the Member States "to speed up liberalization in areas such as gas, electricity, postal services and transport." The Lisbon Strategy consequently aims at achieving a fully operational internal market in these areas, see n. 1, no. 17.

381 It may be recalled that the Commission claims, in accordance with economic theory, that only ownership separation eliminates the incentives or the ability of the regulated firm to act in an anti-competitive manner. Less rigid forms of structural separation such as accounting, management or legal separation are assumed not to eliminate such incentives. In a regulatory setting, the latter kinds of structural separation are often chosen as a supplement to other (behavioural) approaches such as access regulation in order to limit the incentives and to additionally control the incumbent's ability to restrict competition. See also n. 233.

382 See already n. 118.

383 Complemented by two further Directives in 1995, Directive 95/18/EC of 19 June 1995 on the licensing of railway undertakings, OJ L 143/70, 27.6.1995, and Directive 95/19/EC of 19 June 1995 on the allocation of railway *infra*structure capacity and the charging of *infra*structure fees, OJ L 143/75, 27.6.1995.

European rail freight network to international goods services, with the entire network following in 2008.[384] A third step was the adoption of the Second Railway Package at the end of April 2004, inter alia creating a European Railway Agency for Safety and Interoperability and allowing for the full opening of international freight by January 2006 and of domestic freight by January 2007.[385] The completion of EU liberalization efforts is envisaged by a third railway package whose approval is currently pending and which would inter alia include passenger service liberalization by 2010.[386] With Directive 2001/14/EC the EU actually endeavours to achieve vertical separation. The Directive requires that the allocation of *infra*structure capacity and the setting of track usage charges is managed and performed by an entity legally independent from any railway undertaking. This can be achieved by an *infra*structure manager if legal separation between *infra*structure and operations has been opted for by a Member State, or by an independently accountable entity of the incumbent railway undertaking if such legal separation has not been chosen. This rather cautious approach has been taken because railways are regarded as a technically highly complex industry in a rather poor financial state. Furthermore, rail transport already faces stiff competition by alternative transport means such as road and air transport (the latter also showing characteristics of a natural monopoly).[387] More rigid forms of structural separation in this sector are widely considered to be too costly and economically harmful, at least for the time being.[388] For technical reasons, competition of track *infra*structure, which displays very strong monopolistic characteristics (parallel track networks are obviously uneconomical to build), is impossible to achieve. And last but not least, political resistance contributes to the rather slow and cautious liberalization and integration into an internal market of the often state-owned national railway industries.[389]

The telecommunications industry on the contrary has been formally liberalized since 1998, albeit without providing for legal separation of the *infra*structure

384 Directives 2001/12/EC, 2001/13/EC and 2001/14/EC of 26 February 2001 (OJ L 75/1–46, 15/3/01), providing for rules on the development of the Community's railways, on licensing of railway undertakings, and on the allocation of railway *infra*structure capacity, the levying of charges for its use and safety certification.

385 Directive 2004/49/EC of 29 April 2004 (Rail Safety Directive), OJ L 164/44, 30.4.2004, and Regulation (EC) No 881/2004 of 29 April 2004 on establishing a European Railway Agency, OJ L 164/1, 30.4.2004.

386 L Di Pietrantonio, J Pelkmans, 'The Economics of EU Railway Reform', (2004) Journal of Network Industries 295, 304; Commission Staff Working Paper, 'Horizontal Evaluation of the Performance of Network Industries Providing Services of General Economic Interest', SEC(2004) 866, Brussels, 23.6.2004, pp. 19 *et seq.*

387 Di Pietrantonio/Pelkmans, n. 386, pp. 297 *et seq.*

388 In the UK, for example, ownership separation of the track *infra*structure from train service operations has been pursued and ended in vain, see OECD, n. 52, p. 43.

389 Di Pietrantonio/Pelkmans, n. 386, pp. 339 *et seq.*

from telecommunication services.[390] It was only in the second half of the 1990s that local loop unbundling (LLU) became an issue. The local loop, also called the local or customer access networks or the last meter to the final customer, displays monopolistic characteristics as the high costs of the duplication of the local access *infra*structure prohibit new market entry. Unbundling of the incumbent's local access network allows entrants to lease the incumbent's local lines in order to get access to end users. Access to the local loop was therefore considered as a substitute to facility-based entry, i.e. building a parallel local loop, and important for operators of a network backbone connecting different local switches on which local loops hinge.[391] Whereas until 2000 it was for the EU Member States to decide about regulating access to the local loop[392], LLU was made compulsory EU-wide in 2000.[393] LLU only applied to operators, which had been designated by their national regulatory authorities as having significant market power (SMP) in the fixed telephone network supply market with the determination of SMP now being at the core of the New Regulatory Framework for Electronic Communications of 2002.[394] LLU as regulated for on European level is not

390 For an in-depth analysis of the EU legislation up to full liberalization, see Larouche, n. 118, pp. 15 *et seq.* In June 1999, the so-called Cable Directive (Commission Directive 99/64/EC of 23 June 1999 amending Directive 90/388/EEC in order to ensure that telecommunications networks and cable TV networks owned by a single operator are separate legal entities, OJ L 175/39, 10.7.1999) was adopted imposing legal separation between telecommunications services and cable television network. See also OECD, n. 52, p. 49. But see also the recent discussions in the European Commission with a view to introduce "functional unbundling" (the vertically integrated telecommunication undertakings would still own their networks, but have to create a separate management structure under the supervision of the national regulator) of the vertically integrated telecommunications networks in general and the local loop in particular (with British Telecom (BT) serving as an example), Financial Times, 'EU Commissioner favours telecoms break-up', 29 March 2007, and 'Brussels split over telecoms', 24 September 2007. These plans are, interestingly, opposed by Competition Commissioner Kroes because she fears investment disincentives for the undertakings concerned, a concern, which does not seem to come to trouble her in the case of energy supply, which is at issue here.

391 P de Bijl, M Peitz, 'Local loop unbundling in Europe: experience, prospects and policy challenges', TILEC Discussion Paper DP 2005–008, Tilburg University, March 2005, pp. 4 *et seq.* Critics contest whether short-term competition through the compulsory granting of access comes at the cost of more long-term competition through enhanced investment. Directive 2002/19/EC, n. 131, also states that "the imposition by national regulatory authorities of mandated access that increases competition in the short term should not reduce incentives for competitors to invest in alternative facilities that will secure more competition in the long term."

392 See, however, the Europen Commission's Notice on the application of the competition rules to access agreements in the telecommunications sector, n. 178.

393 Regulation (EC) No 2887/2000 of 18 December 2000 on unbundled access to the local loop, OJ 2000 L336/4, 30.12.2000.

394 See M Bak, 'European Electronic Communications on the Road to Full Competition: the Concept of Significant Market Power under the New Regulatory Framework', (2003) Journal of Network Industries 293, 299. The New Regulatory Framework for services and network alone consists of five Directives and one Regulation, i.e. Directive 2002/21/EC of 7 March 2002 on a common regulatory framework for electronic communications networks and

structural separation though, but rather a form of access regulation – the incumbent retains ownership and the responsibility for the maintenance of the lines which are then leased to rival operators.[395] The reasons for not pursuing structural separation of the local loop are mainly two-fold. First, the boundaries between network *infra*structure components and telecommunication services provision are blurred and hard to define, for technical as well as for legal reasons (e.g. the question whether voice over IP is to be qualified as data or the legal question whether the subsequent lease (following the initial lease) of a fixed telephone line is to be qualified as downstream service provision). As the telecommunications market is characterized by rapid technological change[396], these boundaries tend to shift over time so that certain parts of the network defined today might not display the same characteristics tomorrow. Secondly, although the local loop displays monopolistic characteristics, these seem to become weaker over time as technically and commercially viable alternatives are built or developed, such as mobile phone services and broadband and cable *infra*structures for which legal separation has already been introduced.[397] Therefore, regulating (third party) access and network interconnection appears to be sufficient in this industry.[398]

In most European Member States[399], the postal services sector is still characterised by a legal monopoly[400] for reserved letter delivery services conferred upon one

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services (Framework Directive), OJ L 108/33, 24.4.2002, Directive 2002/20/EC of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive), OJ 2002 L 108/21, 24.4.2002, Directive 2002/19/EC, n. 131, Directive 2002/22/EC of 7 March 2002 on universal service and user's rights relating to electronic communications networks and services (Universal Service Directive), OJ 2002 L 108/51, 24.4.2002, Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services, OJ 2002 L 249/21, 17.9.2002, and Regulation 2887/2000, *ibid*.

395 OECD, n. 52, p. 50.

396 De Bijl, n. 128, p. 12.

397 OECD, n. 52, pp. 46–7. See also de Bijl/Peitz, n. 391, p. 33, about the declining role of local access networks.

398 LLU has, however, long been under consideration on a national level. In the UK, for example, the sector was assessed in 2004 and 2005 with a view to proceeding with structural separation of the local loop should access regulation prove to be insufficient to sustain effective competition, see UK telecommunication regulator Ofcom's 'Strategic Review Telecommunications Phase 2', www.ofcom.org.uk/consult/condocs/telecoms_p2, which culminated in undertakings offered by incumbent British Telecommunications plc ('BT') on 30 June 2005 and accepted by Ofcom on 22 September 2005, see www.ofcom.org.uk/media/news/2005/09/nr_20050922. See also www.ofcom.org.uk/static/telecoms_review/index.htm.

399 With the exception of Sweden and Finland, see Council of the European Union, 'Annual Report on Structural Reforms – 2002', Report 6912/02, Brussels, 6 March 2002, p. 22.

400 As opposed to a natural monopoly whose characteristics cannot be found in the labour-intensive postal services industry. The setting-up of a postal *infra*structure parallel to the one owned by the incumbent is neither capital-intensive nor extensively time-consuming, two

service provider by the State.[401] Although considerable competition has been introduced by European legislation to the sector of the postal services industry serving business customers, this legal monopoly, which in essence covers the regular local delivery of letter mail to households[402], is maintained mainly for universal service (including economies of scope) considerations. Additionally, the danger of job losses and with it political resistance have so far hindered the liberalization of this industry. The complete abolition of the legal monopoly and as a consequence full liberalization and completion of the internal market in postal services is envisaged for 1 January 2009.[403]

In contrast to the industries discussed before, the relative technical simplicity (i.e. the clarity of the interface boundaries) and healthy economic state of the energy sector (compared to rail) made it easier to introduce legal unbundling of vertically integrated electricity and natural gas undertakings[404] (structural approach) combined with network access regulation (behavioural approach).[405]

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important factors whose existence make the facility-based entry of new entrants into a network industry which displays monopolistic characteristics economically impractical, see also de Bijl/van Damme/Larouche, n. 221, who consider the network industry character of postal services problematic. See also de Bijl, n. 128, pp. 11 *et seq.*

401 Directive 2002/39/EC of 10 June 2002 amending Directive 97/67/EC with regard to the further opening to competition of Community postal services, OJ 2002 L 176/21, 5.7.2002, which further limits the service sectors that can be protected from competition, allows Member States to exempt items of correspondence weighing less than 100 grams from competition until the end of 2002, and items weighing less than 50 grams until the end of 2005. It sets 1 January 2009 as the date for the full accomplishment of the Internal Market for postal services, to be confirmed by the European Parliament and the Council. As to the network industry characteristics of postal services, see de Bijl/van Damme/Larouche, n. 221, p. iv. See also OECD, n. 52, p. 51.

402 See OECD, n. 52, p. 51.

403 See Article 7 of Directive 97/67/EC of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, OJ 1998 L 15/14, 21.1.1998.

404 See the 2003 Energy Directives and the Introduction *supra*. The way the unbundling measures currently in place affect the fundamental rights of the privately owned energy supply undertakings are not the subject of this work.

405 As a result of the Commission's determination that after the introduction of the first liberalization package (containing milder forms of structural separation such as accounts unbundling) competition in the energy sector had not developed as desired. Legal unbundling increases transparency, makes cross-subsidies within integrated undertakings more visible and, therefore, regulation especially of the transportation part of the industry easier to regulate. For a recent account of the state of internal energy market liberalization, see the Communication of the Commission, n. 10. For an early account of the revision of the first liberalization package, see Hancher, n. 118. Hancher also analyses the PSO and USO in the new Directives, in particular in the context of the concessions made by the European Commission in this respect in order to win the Member States acceptance of further liberalization of the internal energy market.

In addition, energy networks display the strongest characteristics of a natural monopoly in the sense that alternative means of transporting services are not available compared, for instance, with the telecommunications industry where alternative transmission modes exist and the rail transport sector where competing modes of transport exist. It is this lack of *infra*structure alternatives[406], which makes investment *infra*structure in traditional network-bound energy transportation so important. Above all, however, energy supply is the backbone of economic activity in the European Union (which includes being the basis for any other network industry activity). It is *the* most indispensable industry for the internal market in the European Union to function and for competition in the internal market to flourish.

Energy supply security and the reliability of the energy networks are thus predominant components of European energy policy, as already indicated in chapter 1 above when outlining the rationale behind economic regulation of the energy networks. They are made subject to Public Service Obligations (PSOs) which are imposed on energy supply undertakings, in particular energy network operators[407], and, more importantly, are the subject of separate security of supply Directives.[408] The imperative for security of supply distinguishes the energy supply sector from other liberalized network industries such as the telecommunication and rail transport sectors. Energy supply security and reliability provides the Commission with a further argument in favour of ownership unbundling of the energy (transmission) networks.

Whereas security of gas supply predominantly aims at securing sufficient volumes of gas throughout the EU (in the "spirit" of solidarity amongst the EC Member States and in particular in the event of sudden crisis), and at ensuring sufficient gas storage and interconnection of the national gas systems[409], security of electricity supply instead aims at sufficient reliability (quality) of electricity

406 Apart from may be LNG, which, however, also requires traditional gas pipelines to deliver the converted gas.

407 In this regard, see the Directives referred to in n. 404.

408 Directives 2004/67/EC (security of gas supply) and 2005/89/EC (security of electricity supply), n. 356. Both Directives are supposed to complement the 2003 Energy Directives with their market opening rules by imposing additional obligations of the Member States to maintain secure networks and to promote a stable market framework for investments. Neither Directive, however, is supposed to affect the sovereign rights of Member States over their own natural resources, which also include providing (sufficient) electricity generation capacity. See in this regard the discussion in the context of Article 175 EC and the new Article 194 TFEU (after the coming-into-force of the Lisbon Treaty) *infra*; both Articles deal with the sovereignty as regards the system of energy supply albeit with different emphases. New Article 122 TFEU (ex Article 100 EC after the coming-into-force of the Lisbon Treaty) clarifies that Community action can also be taken if energy supply difficulties arise.

409 Consequently, the Directive on the security of gas supply is based on Article 100 EC.

supply networks, which is mainly concerned with maintenance and renewal investment into the electricity networks.

With regard to electricity supply, in the EU the generation of electricity as "secondary" energy resource depends increasingly on gas as "primary" energy input. The aims of the Directive on the security of electricity supply appear in the wider context of safeguarding competition in a functioning internal energy market[410], which include ensuring appropriate levels of generation reserve capacity, facilitating new generation capacity and taking appropriate measures to ensure a regulatory framework that encourages investment in new interconnection between Member States.

It is against the background of the objectives of these two energy supply security Directives, which clearly show that (only) sufficiency of supply of gas and electricity really matters as a safeguard of competition in a functioning internal (energy supply) market, that divestiture or legal ownership unbundling of energy transmission networks is not the next tool to support the achievement of energy supply security as the Commission wants to make everybody believe. As has been shown in chapter 2 section II(3) above, in particular in the context of economic reasoning, if sufficient generation capacity is available (which the Directives aim at promoting) the divestiture or legal ownership of energy transmission networks loses its effectiveness or, in other words, does not offer much additional benefit if any.[411]

Four network industries in four different states of liberalization displaying very different grades of competition have been briefly discussed here. It seems that the clearest case, if any, for legal (ownership) separation would be the European energy supply industry, which is one of the most indispensable economic sectors in the EU and thus plays a highly important role in the development of the internal market and in the effective functioning of competition in the internal market. Against this background, security and reliability of energy supply is of

410 Consequently, the Directive on the security of electricity supply is based on Article 95 EC.

411 Haucap, chapter 2 section II 3, actually argues that ownership unbundling (and "deep" independent system operation) of gas transmission is detrimental to gas supply security. In addition to his argument, it is also often argued that if vertically integrated gas supply undertakings were broken apart, gas producers would lose the secure outlet for their production in terms of steady demand (in favour of more gas supply undertakings entering gas wholesale and retail), which they have counted on when making specific gas production and *infra*structure investment. The risky nature of such investment has also been recognized when allowing for exemption from TPA in Article 22 Gas Directive 2003 and Article 7 Electricity Regulation 1228/2003. It is therefore feared that gas prices would rise instead of falling as a result of seemingly greater competition in gas supply.

eminent importance and thus sufficient investment in particular in generation capacity and the energy networks is considered indispensable.

III. EVOLUTION AND LATEST STATUS OF EUROPEAN ENERGY SUPPLY POLICY AND LEGISLATION

As a basis for the answer to the question whether the European Union is allowed to introduce further unbundling measures by way of energy sector-specific legislation, it needs to be appreciated how European energy policy evolved and what is already in place in terms of energy sector-specific regulation. It has already been claimed that the process of market integration and promotion of competition in the European energy markets are already comprehensively regulated, which will become apparent during the discussions to follow. What also becomes clear in the course of these discussions, however, is that the rather comprehensive sector-specific regulation already in place still leaves leeway to the Member States on important issues, which leads to regulatory gaps and incoherence. Particular emphasis will be put on so-called "regulation by cooperation" to show how many of these shortcomings have been or are on their way to be remedied. It will certainly be the task of further regulatory measures to close these gaps in order to create greater coherence. However, greater coherence only appears achievable if each regulatory measure is fine-tuned to the whole body of measures to be applied to the sector. Too radical an individual regulatory measure puts the framework of energy regulation out of balance and renders it even more incoherent.[412] Thus closing the regulatory gaps and deepening the coordination process at European level appears to be the way forward for the time being in order to test whether more radical measures are required to force greater competitiveness onto the sector.

In the 1950s, the European energy sector was considered an area of economic policy, which required rather urgent development of common policies and coordinated actions.[413] The lack of a special chapter on energy in the 1957 Treaty establishing the European Economic Community (EEC), a state which has lasted until today[414], and which would change once the Lisbon Treaty, which contains

412 In this respect, see Ehlers, n. 7, and Pielow/Ehlers, n. 35.

413 See E Cross, B Delvaux, L Hancher *et al.*, 'EU Energy Law', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, chapter 5, nos 5.06 *et seq.*

414 It was not until the 1992 Maastricht Treaty (Treaty on European Union of 7 February 1992, OJ 1992 C 191/1, 29 July 1992) that the 'spheres of energy, civil protection and tourism' were listed in Article 3 EC amongst the various Community activities, and Article 129b (now 154) EC on the promotion of trans-European networks (TENs) in the areas of transport,

such a chapter[415], comes into force[416], hindered the development of Community law and policy well into the late 1980s.[417] It was not until the end of 1995 that the European Commission in its White Paper on 'An Energy Policy for the European Union' laid the foundation for an EU policy reconciling competitiveness, security of supply and environmental protection.[418]

In 2000, the Lisbon Agenda among other things set out the commitment to complete the market opening process for network industries including electricity and gas. This objective led to the second generation of Electricity and Gas Directives in summer 2003[419], which revised and repealed the first generation of internal energy market legislation, the 1996 Electricity and the 1998 Gas Directives.[420] The two 2003 Energy Directives were accompanied by a 2003 Regulation on cross-border trade of electricity and complemented in 2005 by a Regulation on gas transmission networks.[421] The first three measures became operative on 1 July 2004, the last on 1 July 2006. On 10 January 2007, the European Commission published the final report on its energy sector inquiry and the latest internal energy market progress report[422], which both led to the Commission's first strategic review of EU energy policy as set out in the

telecommunications and energy *infra*structures was added. See in greater detail, *infra* subsection IV.

415 See nn. 300, 368, and in greater detail, *infra*.

416 See nn. 368.

417 The first significant and detailed document on the internal energy market, more specifically in the area of electricity was published by the Commission in 1988, see Commission of the European Communities, 'The Internal Market for Electricity', COM(1988), 238 final, Brussels, 2.5.1988, which initiated the Internal Energy Market Programme (IEM), see in more detail, Eberlein, n. 159, pp. 59, 63 *et seq.* For an extensive account on the early stages of the internal market for energy, see Hüffer/Ipsen/Tettinger, n. 367. See also L Hancher, 'A Single European Energy Market – Rhetoric or Reality?', (1990) Energy Law Journal 217.

418 European Commission, 'An Energy Policy for the European Union', COM(95) 682 final, December 1995. See also Council Resolution of 8 July 1996 on the Commission's White Paper, OJ 1996 C 224/1.

419 See n. 16 and accompanying text.

420 The first generation of Energy Directives of 1996 and 1998, n. 49, did not require full liberalization of the national energy industries but merely set minimum standards allowing for different degrees of liberalization to co-exist. They established, for the first time, some common rules for the organization of the energy sector. For an excellent analysis of the latter Directives and the draft 2003 Directives, see Hancher, n. 118.

421 Regulation 1228/2003 on conditions for access to the network for cross-border exchanges in electricity, n. 219, and Regulation (EC) No 1775/2005 of 28 September 2005 on conditions for access to the natural gas transmission networks, OJ L 289/1, 3.11.2005. The Gas Regulation is not confined to interconnections as is the Electricity Regulation. For more details, see L Hancher, I del Guayo, 'The European Electricity and Gas Regulatory Forums', in B Barton, L Barrera-Hernández, A Lucas, A Rønne (eds), *Regulating Energy and Natural Resources*, OUP, 2006, chapter 13, pp. 243 *et seq.*, 245 *et seq.*, 249 (note 15).

422 NN. 3, 10.

Communication "An Energy Policy for Europe"[423], and to the tabling of proposals for a third generation of internal energy market legislation consisting of five legislative instruments on 19 September 2007[424]: two Directives amending the above mentioned 2003 Energy Directives, two Regulations amending the two above mentioned Regulations and a Regulation establishing an Agency for the Cooperation of Energy Regulators (ACER).[425] On 9 and 10 October 2008, the Council of Energy Ministers of the Member States reached a common position on these five pieces of legislation, which was followed by a second strategic EU energy policy review of the Commission.[426]

Although the two 2003 Energy Directives have brought about a common set of rules which are much more detailed than the first set of Energy Directives (of 1996 and 1998), they have still left considerable scope for implementation at Member State level. The subsidiarity inherent in this legislative approach has not fully eradicated the divergence among Member States as regards national energy specific regulation and its application to the sector, which the European Commission considers conflicts with the declared aims of the European Union to create an internal and competitively structured European market for energy.[427] The two predominant features of the 2003 Energy Directives are the introduction

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423 Striving to achieve a truly competitive EU-wide internal energy market within three years in order to comply with the time limit set by the Lisbon agenda, see nn. 1, 6. In greater detail on this first strategic review, see Ehlers, n. 7.

424 Only the legislative instruments and related documentation, which address internal energy market issues directly, are listed here. Other legislative measures are, for instance, in the area of energy supply security, the already mentioned Directives 2005/89/EC and 2004/67/EC, n. 356, and in the area of sustainable energy supply, Directive 2001/77/EC of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market, OJ 2001 L 283/33, 27.10.2001, Directive 2004/8/EC of 11 February 2004 on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending Directive 92/42/EC, OJ 2004 L 52/50, 21.2.2004, and Directive 2003/30/EC of 8 May 2003 on the promotion of the use of biofuels or other renewable fuels for transport, OJ 2003 L 123/42, 17.5.2003. With respect to energy efficiency, Directive 2002/91/EC of 16 December 2002 on the energy performance of buildings, OJ 2003 L1/65, 4.1.2003, might serve as an example. All these measures are interrelated as regards their objective of achieving an internal energy market, which is sustainable, secure in terms of supply and competitive. For a fairly recent account of other energy related issues on the Agenda of EU energy policy, see Ehlers, n. 7. The most recent developments in EU energy policy can be found at on the European Commission's website "Energy policy for a competitive Europe" at http://ec.europa.eu/energy/index_en.htm.

425 N. 15.

426 In the meantime, the five pieces of legislation have passed the European Parliament, see nn. 31, 33 (and accompanying text), 95, 372. For the 2nd strategic review, see European Commission, 'Second Strategic Energy Review – An EU Energy Security and Solidarity Action Plan', Communication, SEC(2008) 2794–5, Brussels, November 2008.

427 See P Cameron, 'Completing the Internal Market in Energy: an Introduction to the New Legislation', in P Cameron, (ed.), *Legal Aspects of EU Energy Regulation – Implementing the New Directives on Electricity and Gas across Europe*, OUP, 2005, chapter 2, p. 8, no. 2.02.

of regulated TPA, and legal and management unbundling of all energy network operators until July 2007[428] as a safeguarding measure because TPA to the energy networks, as has been shown above, is one of the most important prerequisites for the creation of a competitive internal energy market.

It should be recalled that regulated TPA is intended to safeguard non-discriminatory network access to all market participants more effectively, while the more stringent unbundling measures have been put in place to address the perceived barriers to competition created by corporate structure. These two measures require stringent institutional enforcement by National Regulatory Agencies (NRA), whose independence and policing powers have been considerably strengthened by the 2003 Energy Directives and are further strengthened by the proposals for Energy Directives of September 2007.[429] These Directives have brought about a minimum set of competences for NRAs with an emphasis on tariff and network access regulation. What is more, NRAs have obtained an advisory role on implementation and further shaping of European-wide regulatory measures through the European Regulators' Group for Electricity and Gas (ERGEG).[430]

Taking the main two aims of the 2003 Directives, it seems that bringing about full liberalization in terms of quantitative (or formal) market opening by July 2007 has largely been achieved, whereas enhancing qualitative (or substantive) regulation and bringing about more uniformity and coordination of national regulation has made major progress.[431] However, major shortcomings remain,

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428 Including the tightening the requirements of functional unbundling. As regards the different kinds of unbundling measures, see already the extensive discussions in the Introduction.

429 See n. 425, and here in particular Articles 22c and 24c of the proposed Electricity and Gas Directives, respectively. For a critical review, see U Ehricke, 'Die von der Kommission geplanten Kompetenzerweiterungen der Regulierungsbehörde auf dem Energiesektor nach den Entwürfen zur Änderung der Richtlinien 2003/54/EG und 2003/55/EG und deren Vereinbarkeit mit Article 3 Abs. 1 lit. G) EG-Vertrag', (2008) RdE 159; W Höfling, S Augsberg, 'Grundrechtsfragen im Zusammenhang mit der geplanten Erweiterung der Befugnisse der nationalen Regulierungsbehörden auf den Strom- und Gasmärkten', (2008) RdE 353.

430 In order to facilitate the mandatory contribution of NRAs to the development of the internal market and a level playing field by cooperating with each other and the Commission in a transparent manner, see Article 23(12) of the 2003 Electricity Directive, Article 25(12) of the 2003 Gas Directive, Article 9 of the 2003 Electricity Regulation, the Commission established the independent advisory group ERGEG at the end of 2003, see Commission Decision 2003/796/EC of 11 November 2003 on establishing the European Regulators Group for Electricity and Gas, OJ 2003 L 296/34, 14.11.2003. Its purpose is it to 'contribute to the effective market opening in practice by promoting consistent approaches to market regulation throughout the Union', press release of the European Commission of 12 November 2003, 'Commission creates European Regulators Group for Electricity and Gas', IP/03/1536.

431 See for the distinction between quantitative market opening and qualitative regulation, Cameron, n. 427, p. 16, no. 2.20.

which become obvious from the letters of formal notice sent by the Commission to 17 Member States on 4 April 2006 informing them about matters of non-compliance with the 2003 Energy Directives[432], and a series of Commission Reports on the progress of the internal energy market and the sector inquiry.[433]

Looking at the 2003 Energy Directives more closely and starting with electricity transmission and distribution, Member States are required to ensure that the system of TPA they implement is based on published tariffs, applicable to all eligible customers and applied objectively and without discrimination between system users.[434] The rationale behind regulated TPA is to promote competition in the wholesale market, rather than in the retail supply market. Refusal of access is, however, still possible where sufficient capacity is not available.[435] The reasons for such refusal must be substantiated, taking public service obligations into account.[436] Where appropriate, the Member States have to ensure that the TSO or DSO refusing access provides relevant information on measures that would be necessary to reinforce the network.

As regards gas transmission and distribution networks, TPA also has to be granted on the basis of published and regulated tariffs[437] albeit with a number of exceptions. As regards access to storage facilities and line pack[438], Member States can opt for negotiated or regulated TPA, whereas access to upstream pipelines continues to be at the discretion of the Member States.[439]

Although regulated TPA in gas and its refusal closely resemble the provisions in the 2003 Electricity Directive, the following differences concerning long-term transportation contracts and cross-border transmission are worth mentioning: first, TPA should not prevent the conclusion of long-term contracts as long as they comply with EC competition law[440], and secondly, TPA may be refused on the ground that it would cause serious economic and financial difficulties with

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432 See for the list of issues causing these complains, Hancher, n. 49, p. 97. See also NERA Economic Consulting, 'EC Challenges Member States Over Regulation of Electricity and Gas Markets', Energy Regulation Insights, Issue 29, April 2006.

433 For details on the latest progress report and the final report of the sector inquiry, see nn. 3, 10.

434 Article 20(1) Electricity Directive 2003.

435 Article 20(2) Electricity Directive 2003.

436 As regards the provisions relating to public and universal service obligations in the 2003 Energy Directives and their consequences for the development of a competitive and internal market for energy, see n. 118 and accompanying text.

437 Article 18 Gas Directive 2003.

438 A means of storing gas by compressing it within the transmission and distribution systems.

439 Articles 19(1), 20 Gas Directive 2003.

440 Article 18(3) Gas Directive 2003.

take-or-pay contracts.[441] Finally, TSOs, which have to transmit gas across borders, must be granted access by the TSOs of the gas networks required for such transmission.[442]

As regards access to gas storage, line pack and ancillary services, Member States can chose negotiated and/or regulated TPA. In any event, the regime chosen has to be operated in an objective, transparent and non-discriminatory manner. Market actors require access to these parts of the gas networks as it is an important and flexible tool assisting them in reducing the prices for electricity and gas they have to pay for by, for example, buying on spot markets. Gas storage is also a tool for electricity generators to ensure continuity of supply.

The 2003 Gas Directive's provisions for access to gas storage come with an Interpretation Note of the Commission[443] containing guidelines, which are not legally binding, which endeavour to limit the exemptions from the Directive's access provisions to such storage facilities, which are required by gas transmission operators (TSOs) to fulfil their function, and those facilities, which are needed in the context of production. Further, these guidelines specify the information which storage system operators should provide to system users to enable them to access the system efficiently.[444]

Access to upstream pipelines effectively remains negotiable.[445] Although the Member States have to take measures to make these networks accessible to natural gas undertakings and eligible customers, the form of such access can be determined by the individual Member State, which has to observe objectives such as fair and open access, establish a dispute settlement mechanism operated by an authority which is independent of the parties involved and must have access to

441 Article 21(1) Gas Directive 2003. Take-or-pay gas contracts basically oblige the buyer to pay for a percentage of the contracted quantity even if the buyer fails to take the gas supplied. The seller usually imposes such an obligation to guarantee a predictable minimum cash flow, and financial institutions involved in the gas field or pipeline development may require these obligations as a condition for financing. According to Article 21(2) Gas Directive 2003, the Member State has to ensure in the case of refusal of TPA that the refusing natural gas undertaking makes the necessary enhancements to the pipeline network if it is economic to do so or when potential customers are prepared to pay for them. Article 21(1) Gas Directive 2003 has to be read in conjunction with Article 27 Gas Directive 2003 (derogations in relation to take-or-pay obligations). On these issues, see also Talus/Wälde, n. 47.

442 Article 18(2) Gas Directive 2003.

443 European Commission, 'Third Party Access to Storage Facilities', Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the Internal Market in Electricity and Gas, 16.1.2004.

444 The 2003 Gas Directive requires the establishment of storage system operators, which have to obey the Directive's provisions for system operators including the requirement to provide information to system users.

445 Cameron, n. 427, p. 16, no. 2.26.

all information relevant to the dispute. On the other hand, Article 20 of the 2003 Gas Directive also affords a certain extent of protection to the owners and operators of upstream pipelines.

TPA to electricity and gas *infra*structure may be waived in specific cases involving major new *infra*structure projects (including Liquefied Natural Gas (LNG) and gas storage facilities) and significant increases in capacity in existing interconnectors.[446] An exemption can only be granted if such projects fulfil the following criteria: the investment proposed for an exemption must contribute to competition in supply (and in the case of gas *infra*structure, enhance security of supply), must not be detrimental to the functioning of the internal market, and, most importantly, the level of risk attached to the investment must be such that it would not be undertaken if the exemption is not granted. In both cases, the *infra*structure must also be owned by a natural or legal person, which is separate at least in terms of its legal form from the system operators in whose systems that *infra*structure will be built, so that possible cross-subsidies can be laid open to scrutiny more easily. Exemptions will not be granted for *infra*structure, whose construction has been financially committed to before 15 July 2003, and they are only allowed to be granted on their merits on a case-by-case basis. The requirement not to grant exemptions where such new *infra*structure would create or reinforce a dominant position or where it would reduce the scope for diluting existing dominant positions, might appear odd in the context of energy *infra*structures, in particular *infra*structures relating to electricity (which we should recall is not storable and whose flow cannot be steered along certain paths as it follows the path of least resistance), which are characterized by monopolistic properties (naturally putting its owner or operator in a dominant position) unless built in parallel and by different owners.

The decisions of the NRA, to which the application for an exemption has to be made, have to be communicated to the Commission with all the relevant information, which can request decisions to grant an exemption to be amended or even withdrawn.[447]

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446 Article 22 of 2003 Gas Directive, Article 7 of 2003 Electricity Regulation, both of which are similar in structure and content.

447 The absence of precise criteria for a possible rejection by the Commission has been criticized as a source of uncertainty where *infra*structure investment is much needed, see Cameron, n. 427, p. 16, no. 2.29. On the other hand, many exemptions have in the meantime already been granted in both electricity and gas, see, for instance, the Commission's website at http://ec.europa.eu/energy/*infra*structure/ electricity/electricity_exemptions and gas/gas_exemptions.

The 2003 Energy Directives also introduce three kinds of unbundling of the network businesses from the vertically integrated energy supply undertakings[448], which complement the Directives' endeavours to ensure non-discriminatory TPA to the energy networks with a view to addressing the structural constraints on the creation of an internal market.

It may be recalled that legal unbundling requires the formal separation of the energy network business (which also includes (cross-border) electricity interconnectors) into a separate legal entity from other vertically integrated activities not related to transmission and distribution, which may continue to operate within one company or group of companies.[449] Functional or management unbundling requires a managerial separation of the network business from the remaining businesses of the vertically integrated energy supply undertaking to guarantee its independence from the remaining businesses in terms of management, organization and decision-making with respect to the assets necessary to maintain, operate and develop networks.[450] Accounts unbundling is the minimum unbundling requirement to be observed by all energy network (operation) businesses and concerns the maintenance of accounts separate from the other activities/businesses of the vertically integrated energy supply undertaking. This form of unbundling will only become relevant for those energy distribution network (DSO) businesses that will not (have to) be legally unbundled.[451] The duties of NRAs include ensuring the accurate application of national accounting principles, and monitoring the businesses to ensure that no cross-subsidies flow from the network (operation) business to the potentially competitive businesses of the vertically integrated energy supply undertaking,

448 See the Introduction for a definition of these types of unbundling. The Commission's understanding of 'vertically integrated undertakings' and 'control' are published in its 2004 Unbundling Note ('The Unbundling Regime', Note of DG Energy & Transport on Directives 2003/54/EC and 2003/55/EC on the Internal Market in Electricity and Gas, Brussels, 16.1.2004). This note, which is part of a series of notes of the same nature on various subject-matters of the 2003 Energy Directives, sets out matters such as ensuring the network operation company's independence from its parent company, minimum criteria for functional unbundling and the organization of combined network operators, but is however not binding, neither on the Member States nor the Commission, and thus hardly remedies the rather vague provisions of the 2003 Energy Directives.

449 Articles 10, 15 of the 2003 Electricity Directive, Articles 9, 13 of the 2003 Gas Directive.

450 Articles 10(2), 15(2) of the 2003 Electricity Directive, Articles 9(2), 13(2) of the 2003 Gas Directive.

451 DSOs not serving more than 100,000 customers can be exempted from the legal unbundling requirement beyond 1 July 2007 by national implementing legislation, Articles 15, 30(2) of the 2003 Electricity Directive, Articles 13, 33(2) of the 2003 Gas Directive.

such as electricity generation/gas production and energy supply to customers (on wholesale and retail level).[452]

In order to promote non-discriminatory conduct from within the vertically integrated energy supply undertakings, the 2003 Energy Directives demand the implementation of a compliance programme in TSOs, DSOs and/or combined system operators[453], which is also supposed to ensure that unbundling is properly enforced. An annual report is to be published and submitted to the NRA to assist in its monitoring tasks.

The 2003 Energy Directives have enhanced the legal status of the NRAs significantly by obliging Member States to charge one or more competent bodies with the function of regulatory authorities and by setting a minimum level of functions and competences for the sake of harmonization.[454] This can lead, however, to regulatory functions being spread over several authorities, such as local or regional regulatory bodies like in Germany where there are national and state regulatory agencies. It can also lead to combinations of NRAs and competition authorities (and even ministries) exercising the regulatory function, which is, for instance, the case in the Netherlands where the energy sector regulator DTe is a directorate within the competition authority NMa. Such forms of organization might impair the obligatory independence of the regulatory authority (or authorities), although it should be noted that this independence is only defined in relation to the interests of the energy industries rather than in relation to the existing government structures (which may be the reason for the failure to ensure such independence).[455]

The general responsibilities of NRAs according to the 2003 Energy Directives are to ensure non-discrimination, effective competition and the efficient functioning of the market.[456] Following from these general tasks, the following activities are specified as tasks for the NRAs:

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452 Articles 19(3) and (4), 23(1)(e) Electricity Directive 2003, Articles 17(3) and (4), 25(1)(e) Gas Directive 2003. Cross-subsidization has successfully been prevented, for instance, in the Netherlands, see NMa, n. 156 and accompanying text.

453 Articles 10(2)(d), 15(2)(d), 17(2)(d) of Electricity Directive 2003, Articles 9(2)(d), 13(2)(d), 15(d) of Gas Directive 2003.

454 Article 23 and Recital 15 of Electricity Directive 2003, Article 25 and Recital 13 of Gas Directive 2003. The NRAs' supervisory role over network access and their power to set or approve network tariffs or at least the methodologies underlying their calculation are now anchored in European law.

455 See in this respect, Cameron, n. 427, p. 19, no. 2.36.

456 Additionally, the NRA acts as dispute settlement authority in complaints against TSOs or DSOs in the context of their obligations under the 2003 Energy Directives, and against decisions of the NRA on tariffs or their methodology, Article 23(5) of the 2003 Electricity

- setting the rules on the management and allocation of interconnection capacity (jointly by the NRAs concerned), ensuring the publication of appropriate information by TSOs and DSOs concerning interconnectors, grid usage, and capacity allocation to interested parties, and creating mechanisms to deal with congestion on the national electricity or gas networks;
- monitoring the time taken by TSOs and DSOs to make connections and to carry out repairs. In this context, NRAs also have to ensure the application of objective, transparent and non-discriminatory terms and condition (including tariffs) for connecting new electricity generation capacity, thereby particularly accounting for the costs and benefits of distributed generation, renewable energy sources (RES) and combined heat and power (CHP). In the case of gas, this responsibility is confined to ensuring such transparent and non-discriminatory conditions for access to storage, line pack and other ancillary services;
- monitoring the effective unbundling of accounts to ensure that there are no cross-subsidies between generation, transmission, distribution, and supply activities, and, in the case of gas, additionally storage and LNG; and more generally
- monitoring the compliance of TSOs and DSOs with the tasks accorded to them by the Directives, and the level of transparency and competition.

Further to the monitoring duties of the NRAs, they are responsible for fixing or approving *ex ante*, i.e. prior to their entry into force, as a minimum the methodologies used to calculate or establish the terms and conditions (including tariffs) for the connection, the access to the national energy transmission and distribution networks and the provision of balancing services.[457]

Further, NRAs play an important role in the application of the Regulations on cross-border electricity exchanges and on gas transmission, which entered into force in July 2004 and 2006, respectively[458], and which enable the adoption of detailed technical rules on network access in order to address restrictions on cross-border trade in electricity and gas. The Regulations provide for arrangements for the exchange of electricity and gas transmission throughout

Directive, Article 25(5) of the 2003 Gas Directive. The NRA also has jurisdiction in cross-border disputes in respect of a system operator that refuses the use of or access to its system.

457 This competence of NRAs might, however, be limited, since they can be required by national legislation to submit their (draft) decisions on tariffs or at least methodologies for formal approval or rejection to the relevant body according to this legislation. And although the formal approval or rejection of the NRA's decision, including their reasons, has to be published, such a procedure slows down the regulatory process, impairs the NRA's reputation and, what is more, significantly hampers the independence of the NRA.

458 N. 421.

the EU and deal with issues such as congestion management, the allocation of available transmission capacity of interconnections between national systems in the EU and the auctioning of such capacity. The application of these rules fall largely into the remit of the Member States' energy regulators.[459] Both Regulations allow the Commission under the Comitology procedure[460] to amend or adopt detailed and legally binding guidelines on these issues[461], such guidelines being largely based on consultations in the course of the so-called *forum process*, which is explained below; these guidelines are then incorporated into the Annexes of the Regulations and become directly applicable in the Member States' legal systems.[462] According to the proposed Electricity and Gas Regulations[463], new structures of cooperation between the Electricity and Gas TSOs are to be introduced by establishing European networks of transmission system operators under the supervision of the Commission and the Agency for the Cooperation of

459 With regard to cross-border electricity interconnectors, although the NRAs decide on exemptions to TPA for new investment, they still require the approval of the Commission, see Article 4 of the 2003 Electricity Regulation. NRA approve the TSOs operational and planning standards including schemes for the calculation of the total transfer capacity, see the Guidelines annexed to the 2003 Electricity Regulation. They supervise the compliance with all guidelines adopted under the 2003 Electricity Regulation, see Article 9, and keep the Commission informed so that it can carry out its duties under the 2003 Electricity Regulation, such as adopting or amending the Guidelines annexed to the Regulation, see Article 10(1), (2), (5).

460 Comitology is the official term used to refer to delegation of decision-making under participation of committees. There are three distinct comitology procedures, using an Advisory, Management or Regulatory Committee, with varying degrees of control over the Commission's power to adopt new rules, see Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ 1999 L 184/23, 17.7.1999. For details and a critique on this procedure in the context of amendments to the Annexes to the Energy Regulations, see Hancher/del Guayo, n. 421.

461 The Electricity Regulation 2003 provides for the adoption of further guidelines by the Commission (Recital 8 and Article 8) and contains in its Annexes two sets of specific guidelines, which have thus become legally binding. Whereas the Commission may or may not decide to adopt the first type of guidelines in its own right in the future, it can only amend the second set. In the Gas Regulation, the Commission is only empowered to amend the annexed guidelines. See also n. 478 as regards the problematic expansion of the Commission powers to adopt legally binding guidelines under the comitology procedure contained in the proposed Energy Regulations and proposed in the context of establishing the Agency for the Cooperation of Energy Regulators (ACER).

462 For a critical view as to the democratic justification of this 'fora process', Hancher/del Guayo, n. 421. The use of Regulations in the energy market establishes the principle that the common rules introduced by internal market Directives, which are based on Article 95 EC, may be narrowed down by means of such Regulations that set out in detail the basic principles and implementation measures for certain key issues related to internal market goals, in particular through annexed guidelines, see P Cameron, 'The Internal Market in Energy: Harnessing the New Regulatory Regime', (2005) European Law Review 631, 636. Whereas Regulations are directly applicable in the Member States, Directives require implementation by the Member States, thereby conferring upon them a certain margin of interpretation.

463 N. 15.

Energy Regulators (ACER), which is to be established under the revised Regulations.[464] These European Networks are supposed to establish regional cooperation[465] and to lead to the publication of regional network investment plans.[466]

Coming back to the legislation in place at present, the 2003 Energy Directives have firmly established the role of NRAs in the sector, which makes cooperation and coordination between these agencies highly relevant.[467] The development of "regulation by cooperation"[468] has played an important role in the Commission's endeavours to achieve an internal energy market.[469] To address the regulatory needs arising from the national implementation of the revised Energy Directives (of 2003), in particular technical and commercial barriers to the creation of fully integrated and operational electricity and gas markets[470], the first step in this development was the establishment the so-called *forum process* by the Commission with two voluntary fora to provide a platform for informal

464 N. 478.

465 See, however, the already existing cooperations such as the so-called Pentalateral Forum, *infra* nn 479 *et seq.* and accompanying text.

466 The Electricity and Gas Regulations as agreed on 9 and 10 October 2008 (and approved by the European Parliament on 22 April 2009, see n. 33, and finally adopted unamended by the Council of the European Union on 25 June 2009, see also n. 33) also provide for the Commission under the comitology procedure to adopt detailed and legally binding guidelines, albeit to a considerably lesser extent than according to the original proposals; with respect to the latter, see the critical review of H Lecheler, 'Die Verschärfung des Regulierungsregimes durch die drei neuen Verordnungs-Entwürfe im Paket vom 19.9.2007', (2008) RdE 167. See also n. 476.

467 Recital 16 of the 2003 Electricity Directive, Recital 14 of the 2003 Gas Directive. The 2003 Energy Directives (Article 23(12) Electricity Directive 2003, Article 25(12) Gas Directive 2003) require the NRAs to 'contribute to the development of the internal market and of a level playing field by cooperating with each other and with the Commission in a transparent manner'.

468 Ever since the first Internal Energy Market Directives entered into force in 1996 and 1998, *regulation by cooperation* based on transnational networks has had an important influence on the evolving regulation of European energy markets and the creation of a single energy market in the EU. See Eberlein, n. 159, pp. 60, 62, 82.

469 The Commission's strong formal power in competition policy, which is fully applicable to the energy sector, was in itself not able to address the regulatory needs of this sector, namely to advance the Single Market agenda, and to ensure that decentralized implementation in the Member States without some level of European coordination does not undermine the establishment of a truly integrated European energy market. Because Member States pursued different liberalization and regulatory strategies, the Commission sought to introduce a mechanism to interconnect national regulatory systems in an integrated market by promoting regulation by coordination in order to address the regulatory needs arsing from the national implementation of the two 2003 Energy Directives. See in more detail, Eberlein, n. 159, p. 65.

470 Competition law cannot produce similar solutions to the regulatory solutions developed by the fora. On the other hand, competition law can be used as a check and driver for the development of the regulatory foundation, playing a complementary role in the supranational regulation of the European energy markets.

discussion and transnational cooperation. The two biannual fora, the Electricity Regulatory Forum, also called 'Florence Forum' or 'Florence Process', and the Gas Regulatory Forum, also called 'Madrid Forum' or 'Madrid Process' were set up in early 1998 and autumn 1999 respectively.[471]

These two processes have allowed for voluntary agreements to improve the competitive conditions of the market and produce informal guidelines, which complement the legislative measures in place.[472] The fora have often been used by transmission system operators to develop solutions, which could be more expeditiously implemented than through legislative measures. The good practice guidelines for gas storage operators and the congestion management guidelines adopted by the Commission are two examples of voluntary agreements of this

471 Given the weak Treaty basis and thin legislative context of energy policy as well as the slow market opening and network integration resulting from the 1996 and 1998 Energy Directives, the Commission had to draw on some level of European coordination in order to promote the establishment of a truly integrated European energy market, i.e. to convert the European patchwork of national energy markets, which on top of national divergences did not provide for any mechanisms to interconnect national systems to an integrated market, into a level playing field throughout the European Union. See in more detail, Eberlein, n. 159, pp. 59 *et seq.* See also Hancher/del Guayo, n. 421, pp. 243 *et seq.* With respect to the Amsterdam Forum on sustainable energy supply and the Berlin Forum on fossil fuel supply, see Ehlers, n. 7.

472 These two fora focus on TPA issues such as on tariffs for cross-border gas and electricity exchanges, the allocation and management of scarce interconnection capacity as well as access to storage facilities, all issues related to the development of an internal energy market. Participants in the fora include the Commission, Member States' officials, representatives of the NRAs, transmission system operators (TSOs), representatives of gas and electricity suppliers and traders, consumers, network users, gas and power exchanges and the Council of European Energy Regulators (CEER), which was constituted in March 2000 comprising energy regulators from 24 Member States except Luxembourg, and Norway and Iceland from the European Economic Area, and which is the link between regulators and the European Commission's Directorate for Energy and Transport (DG TREN). In short, all stakeholders with an interest in the respective subject matter of the respective fora are present. They also contributed to informal settlements in competition cases. See in more detail, Hancher/del Guayo, n. 421. The Florence and Madrid fora had an important impact on the regulatory content of the second generation of energy regulation. They have also produced informal guidelines, which initially complemented these legislative measures and served as a point of reference for informal settlements in competition cases. These guidelines detail principles and rules, particularly on TPA to networks and storage facilities as well as tariff issues, matters, which the 1996 and 1998 Energy Directives failed to address. The fora have significantly contributed to energy legislation moving from the regulatory principle of the first generation of Energy Directives to the greater regulatory detail of the second generation of energy legislation. See in more detail, Hancher/del Guayo, n. 421, pp. 253, 255.

type[473], which have become legally binding by becoming part of the Annexes of the Energy Regulations.[474]

In order to formalize and improve the cooperation and coordination between the national regulators, and to round up this summary of the regulatory framework, the Commission established, as indicated above, the European Regulators' Group for Electricity and Gas (ERGEG) in November 2003[475], which adopts and monitors guidelines resulting from the consultations at forum level, and holds regular meetings with the Commission on all issues related to market liberalization.[476] In its first strategic review "An Energy Policy for Europe", the Commission moved further by proposing a European network of independent

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473 See W Webster, 'Recent Developments in EU Energy Markets', in M Roggenkamp, U Hammer (eds), *European Energy Law Report III*, Intersentia, Antwerp-Oxford, 2006, chapter 1, pp. 3 *et seq.* The fora have successfully attracted expertise, mobilized stakeholders, and clarified the regulatory issues at stake, across established national boundaries. As Eberlein, n. 159, p. 77, has put it, "[t]he crucial resource for informal coordination through networks is […] *information or expertise*. In policy domains, in which decision-making depends on technically complex knowledge, control over credible information, underpinned by professional standards, becomes an important tool of 'soft steering'. *Professionalization*, the fact that the participants share a common professional […] background and meet regularly in similar policy circles, creates a strong, shared frame of reference that facilitates convergence and harmonization."

474 Regulation 1228/2003, n. 219, and Regulation 1775/2005, n. 421. The proposed Electricity and Gas Regulations, n. 15, which would establish European networks of TSOs also confer the responsibility for the drafting and enforcing of technical and market codices, rules on network security and reliability, on the publication and exchange of data, on billing and on interoperability on the European Networks. See Lecheler, n. 466. This conferral would further diminish the role of the fora, see n. 476.

475 See n. 430. The establishment of ERGEG formalizes the informal regulatory role of the Council of European Energy Regulators (CEER) in the forum process, which remains a distinct body; the creation of CEER in March 2000 brought together the energy regulators from the European Economic Area (EEA) Member States.

476 As a result of the creation of ERGEG, the regulators have entered into direct consultations with market participants on the details of advice they are giving to the Commission for later adoption. ERGEG takes a greater role in this process as it is consulted on new guidelines both during the drafting and when the formal proposal is submitted to the comitology committee for approval, see Hancher/del Guayo, n. 421, pp. 246, 253–4, also with respect to the increasingly diminishing role of the two fora. Recital 5 of Decision 2003/796/EC, n. 430, to set up ERGEG as the formal basis for the cooperation of the NRAs explains the relationship between the fora and ERGEG as follows: "Whilst the two forums will remain important as comprehensive discussion platforms involving all players from government, regulators and industry, it is now necessary to give regulatory cooperation and coordination a more formal status, in order to facilitate the completion of the internal energy market […]." ERGEG is now also monitoring the implementation of non-binding guidelines. National regulators are thus subjected to a form of 'peer group' evaluation or pressure forcing national regulators either to conform to European best practice or, when not applying the guidelines, to account for their decisions. Consequently, even though guidelines not incorporated in the Regulations lack formal legal status, they have come to have a significant regulatory impact, see Hancher/del Guayo, n. 421, p. 258.

regulators (so called "ERGEG+" approach). Under this mechanism, the role of ERGEG was to be formalized and given the task of delivering binding decisions for regulators and relevant market players, such as network operators, power exchanges or generators, on certain precisely defined technical issues and mechanisms relating to cross-border issues. As an alternative model, the Commission proposed at the time the setting up of a new, single body at Community level, which would be responsible for regulatory and technical issues relevant to making cross-border trade work in practice. This latter alternative approach eventually led the Commission to propose a Regulation establishing ACER in September 2007[477], the details of which were eventually settled by the Council of Energy Ministers on 9 and 10 October 2008.[478]

One major contribution of ERGEG to the establishment of an internal energy market was the launching of Gas and Electricity Regional Initiatives. Picking the Electricity Regional Initiatives (also called mini fora), they address congestion management, transparency and balancing in the European electricity transmission network on a regional basis.[479] Such regional market initiatives try

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477 See n. 425. The establishment of ACER and the proposed Electricity and Gas Regulations, see n. 463 and accompanying text are designed to complement each other as the Electricity and Gas Regulations draw heavily on ACER and make its tasks operational.

478 See n. 372. For a critical review of ACER and of the two proposals for Energy Regulations, see Lecheler, n. 466, who expresses great concern about the excessive endowment of the Commission with law-making powers with respect to enacting binding guidelines, which only have to pass the comitology procedure, see n. 460, in accordance with which the Commission can also confer additional powers on ACER. In the same vein, denouncing the establishment of such powers as a serious violation of the rule of law and a severe deficit in terms of democratic legitimacy and accountability, see J-C Pielow in his statement at the public hearing of the committee for economic affairs and technology of the German Federal Parliament, Deutscher Bundestag, on 9 April 2008 ('Stellungnahme von Prof. Dr. jur. Johann-Christian Pielow', Öffentliche Anhörung zum Vorschlag der Europäischen Kommission für ein drittes Richtlinien-Paket zum EU-Binnenmarkt vor dem Ausschuss für Wirtschaft und Technologie des Deutschen Bundestages). The current forum process has already raised concerns with respect to its potential democratic deficit and accountability problems, see Hancher/del Guayo, n. 421, pp. 260–1: "The informal consultation with a wide range of stakeholders can be regarded as an effective first step on the way to circumventing national opposition to further loss of sovereignty on energy market issues, […]. It seems that key decisions are taken outside the competent democratic institutions. This seems particularly the case for the guidelines setting out principles and rules, which are albeit legally not binding agreed upon in the fora. They cannot easily be altered during the formalized procedures for the adoption of EU legislation, which in turn raises questions of accountability. On the other hand, the oft en highly technical debates leading to the formulation of guidelines cannot always be properly addressed in a parliamentary setting."

479 Electricity Regional Initiatives were installed for France, the United Kingdom and Ireland, for the Baltic States, for Central Eastern Europe (Germany, Poland, Czech Republic, Slovakia, Hungary, Austria, Slovenia), for Central Southern Europe (Germany, Italy, Switzerland, France, Austria, Slovenia, Greece), for South Western Europe, for Northern Europe (Denmark, Finland, Germany, Norway, Poland, Sweden), and for North Western Europe (Germany,

to resolve problems, in situation where political backing is required to put in place measures needed to promote market integration and to ensure that regulators take coherent measures on both sides of national borders.[480] For the regional Northwest European electricity market, for instance, the effectiveness of this cooperation has already become visible: since November 2006, "tri-lateral market coupling"[481] between France, Belgium and the Netherlands is in place, which is an efficient capacity allocation mechanism for day-ahead trading guaranteeing energy flows in the right direction in relation to spot prices. Maximal use of existing capacity is achieved through load-flow based capacity calculation.[482] Market coupling is extended to the entire Central West region of the Electricity Regional Initiative by January 2009, thereby (linking France, Germany and the Benelux countries together into one region, the so-called Pentalateral Forum).[483] Further, there is a growing integration between the

France, Benelux). For further details, see ERGEG, 'Assessment of the Development of the European Energy Market 2007', Ref: C07-URB-05–03, Brussels, 11 December 2007, and Hancher/del Guayo, n. 421, pp. 245 *et seq*. As regards the establishment of gas regional energy markets, i.e. for the areas North-West, South and South-East, improved transparency and interoperability have been identified as key factors to facilitate market integration. Coherence of the gas initiatives is less important as the gas system is less integrated. Therefore harmonisation of rules within the regions is the most urgent need. The existing voluntary guidelines (as a result of the Madrid Forum) for gas balancing, gas storage, access to LNG facilities and open season procedures have not yet delivered a harmonised approach to these issues as they are not uniformly applied by market participants in all countries, see in greater detail, ERGEG, *ibid*.

480 See Webster, n. 473, p. 12.

481 See APX Group, Belpex, Elia, Powernext, RTE, TenneT, 'Trilateral Coupling of the Belgian, Dutch and French Electricity Markets', Technical Press Briefing, Brussels, 14 February 2007. Market coupling combines the so far separate processes of electricity trading, cross-border interconnector capacity allocation, congestion management and network operation, which enhances the efficient cross-border network capacity utilization, cross-border supply competition and network reliability. For an analysis of the compatibility of market coupling with legal unbundling, see J Kühling, G Hermeier, 'Innovationsoffenheit des Unbundling-Regimes? – Die Einführung neuer Strukturen im grenzüberschreitenden Stromhandel als Bewährungsprobe', (2006) ZNER 27. For an analysis of methods of regional congestion management, see consentec, 'Towards a common co-ordinated regional congestion management method in Europe', study commissioned by the European Commission, Final Report, 12 October 2007.

482 In the France-UK-Ireland region, intraday trading and reciprocal access to balancing markets between France and England have been introduced in 2008. The other major continental initiative "Central-East" is also going for a load flow based capacity calculation Both regions will thus have the same mechanism of capacity calculation and its allocation, which resembles the market coupling mechanisms of the examples of regional electricity markets dealt with in the main text.

483 The Pentalateral Energy Forum comprise of the governments, regulators, electricity TSOs, power exchanges and other market parties, which establishes a uniform platform for electricity trade and network operation in Germany, France and the three Benelux countries from 2009. The Members of this forum also intend to cooperate in the area of gas supply. The Pentalateral initiative strives for improving the cooperation in the field of cross-border exchange, aims at regional integration of electricity markets towards a European energy market in compliance

Nordic countries Denmark, Finland, Sweden and Norway[484], the Baltic countries and the other Northern European market countries Germany and Poland: EstLink[485] and NorNed[486] are two DC cables, which provide additional *infra*structure, and the day-ahead market coupling between Denmark and Germany has established an efficient market link between Germany and the Nordic region from September 2008 (including a platform for secondary trading of transmission rights)[487], which involves the Danish and German electricity TSOs concerned and the power exchanges Nord Pool and EEX.[488]

The structure of the ERGEG Regional Initiatives is efficient so far as it allows different levels of market development to be taken into account while moving toward the common ultimate goal of a single electricity market in Europe.

The current legislative framework promotes regulation by cooperation between national and Community institutions to achieve EU-level policy coordination under conditions of shared governance[489] and, at the same time, puts cooperation

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with Directives 2005/89/EC (security of electricity supply, see n. 356) and 2003/54/EC (internal electricity market, see n. 16) and EC Regulation 1228/2003 (see n. 219). The market coupling method applied in the Pentalateral Forum is based on *available transfer capacity at interconnector* (ATC), which allows for coherence with the same market coupling methods applied between Norway and the Netherlands, Germany and Denmark (Nordic region) and the central eastern market (see n. 482). In greater detail, (flow-based) market coupling within the Pentalateral Forum will involve implicit day-ahead capacity auctions, which are simultaneously coupled with electricity trading contracts to one tradable product, explicit long-term (interconnector) capacity auctions, the coordination of cross-border intraday and balancing energy trading and regional investment plans. See in greater detail, Bundesnetzagentur *et al.* (the other four energy sector regulatory authorities involved), 'Central Western Electricity Regional Energy Market – Action Plan', (end of) 2006.

484 These countries are already market coupled for some time.

485 Between Estonia and Finland connecting the Nordic with the Baltic electricity market since the end of 2006.

486 Coupling the electricity markets between the Netherlands and Norway since May 2008, see in greater detail, van der LIppe/Meijer, n. 44.

487 See European Commission, 'Mergers: Commission approves proposed joint venture between Energinet, E.ON Netz, Vattenfall Transmission, Nord Pool and EEX on management of cross-border power transmission', IP/08/1272, press release of 22 August 2008. See also Energinet.dk, E.ON Netz, European Energy Exchange, Nord Pool Spot, Vattenfall Europe Transmission, 'Market coupling between Denmark and Germany', press release, 02.11.2006.

488 Two regions exhibit significant price correlation. The first is The Netherlands, France, Germany, Austria and the second Finland, Sweden and Norway, see ERGEG, n. 479. The improvement of price correlation occurred while prices in general rose, inter alia due to increasing CO2 prices and fuel prices since late 2005.

489 The governance of the European Union is characterized by shared competencies and joint policy-making on several layers, see Eberlein, n. 159, p. 59. Only very few policy areas are exclusively assigned to the supranational level, with exclusive powers of rule setting. Consequently, policy-making in the European Union is usually pursued at national and supranational levels, and energy policy-making is not an exception, see further section IV *infra*. This framework for policy making is a product of the principle of subsidiarity, see

on a new institutional footing by formalizing transnational cooperation of independent national regulators under Commission leadership, while maintaining informal channels of participation and stakeholder involvement. As a result, a complex, hybrid form of governance has developed, linking national and supranational levels of regulation.

Similarly, it can be said that the forum process and the regional initiatives have established that regulation by cooperation and formal regulation can play complementary roles in supranational regulation. Combinations of informal and formal mechanisms can enhance the effectiveness of EU policy coordination and help sidestep the subsidiarity 'trap'.[490] The forum process, and more specifically its recommendations and guidelines, which have been drafted and adopted by all the different stakeholders, lays the groundwork for the formal regulatory process and serves as an instrument to fill regulatory gaps. European legislation, however detailed, will still need to be interpreted and implemented at national level, and naturally cannot address all current and future regulatory issues arising in a technically complex and evolving policy area. Thus, the need for detailed coordination and interpretation on a transnational basis persists. It can thus be claimed that the proposed legislation[491] creates an institutional framework for regulatory cooperation in the process of integrating the national energy markets towards an internal energy market.[492] This institutionalization, however, diminishes the importance of the Madrid and Florence fora; on the other hand, regional cooperation is becoming increasingly important. In this regard, the mini fora or regional cooperations in place or in the process of evolving significantly contributed to the development of the EU's energy policy, inter alia, to build voluntary consensus and to deliver agreements, which can be regarded as the most difficult part for the Commission to realize given the often rather opposing interests of the parties involved in the forum process. Specifically from the viewpoint of the Commission, the tension between national regulatory competences and supranational regulatory activities or, in other words, between subsidiarity and supranational EU-wide coordination have been to a substantial extent reconciled. It seems that so far, the development of regulatory and stakeholder coordination in particular on regional level, and the current status of the industry have moved the evolving internal energy market rapidly towards completion of the integration process – rapidly taking into account the short time frame of approximately one decade for accomplishing this progress in an

further section VIII *infra*. One of the reasons why the Commission uses the forum process is to escape this subsidiarity 'trap'.

490 See Eberlein, *ibid*.

491 See nn. 425 and 463 and accompanying text.

492 See Eberlein, n. 159, p. 81.

industry, which has operated within a completely opposite market environment and structure for some four decades since the establishment of the European Economic Community in 1957.

IV. EU COMPETENCE FOR ENERGY NETWORK REGULATION

Having dealt with the evolution, current status and some likely future developments of energy network regulation, it is now worthwhile to explore, more generally, the competence of the supranational level for such regulation. Apart from dealing briefly with the current competence issues in subsection 1, subsection 2 will explain the new title on energy introduced by the Treaty of Lisbon.[493]

1. ENERGY ISSUES AS EC OBJECTIVE BUT WITHOUT SPECIFIC EC COMPETENCE

Energy policy has yet never attained the status of a Community task. Although "measures in the sphere of energy" were included as a general goal in Article 3(t) EC (now Article 3(1)(u) EC) of the 1992 Maastricht Treaty[494], a corresponding competence or explicit title in the Treaty, which is normally attached to general goals listed in Article 3 EC, to take measures in the area of energy policy has not been conferred upon the European Union. According to the Member States' "Declaration on civil protection, energy and tourism" attached to the Final Act of the Maastricht Treaty, "the question of introducing into the Treaty establishing the European Community Titles relating to the spheres referred to in Article 3(t) of that Treaty will be examined, in accordance with the procedure laid down in Article N(2) of the Treaty on European Union […]."[495] The Commission, however, declared in the same Declaration "that Community action in those areas will be pursued on the basis of the present provision of the treaties establishing the European Communities."

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493 See n. 368 and accompanying text.

494 N. 414.

495 This has eventually happened in the Treaty of Lisbon, see n. 368 and accompanying text. In the Treaty on the Functioning of the European Union (consolidated version), n. 300, Titles XXIII, XXI and XXII deal with civil protection, energy and toruism, repsectively. Title XXI on energy contains one Article, which is Article 194. This new Title and Article will be dealt with further below.

In particular against the background of the principle of conferred powers in Article 5(1) EC[496], and ever since the first steps towards liberalization of the energy markets in the EU, it has been controversial whether and, if so, to what extent European institutions can rely on general competences of the EC Treaty to take measures in the area of energy policy.[497] Apart form the fact that Member States insist on retaining control over the sector by claiming its strategic economic importance, very different types of organization of the national electricity sectors, in particular with respect to the mix of energy inputs, the degree of import dependence, and even more, the ownership structure, makes European energy market harmonization so difficult to achieve. Only Article 154(6) EC gives the EC the power to establish and develop, through guidelines, Trans-European Networks in the area of transport, telecommunications, and energy *infra*structures.[498] Although this competence to promote the interconnection and interoperability of national networks can be regarded as an important tool to create an internal energy market, it does, however, not confer any regulatory powers to remove any obstacles to cross-border trade, which do *not* result from a lack of *infra*structure.[499]

The competence debate, however, will not be repeated here again. What should be appreciated, however, is that from the Declaration mentioned above, it cannot be inferred that there are no competences at all. On the contrary, with the Commission's stated intention in the said Declaration to pursue Community action in the area of energy on the basis of the present Treaty provisions, it seems that the Member States tacitly agreed that energy sector regulation would be based on competencies such as Articles 94, 95 and 308 EC.[500]

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496 See also ECJ, C-376/98, n. 371, nos 83 *et seq*.

497 See early Hüffer/Ipsen/Tettinger, n. 367. Contra, Scholz, n. 367, Baur/Lückenbach, n. 96, and Baur/Pritschke/Klauer, n. 86. Pro, Jarass, n. 367. See also Lecheler, n. 466, with further references in note 7.

498 In the TFEU, see n. 495, competences with respect to Trans-European Networks are to be found in Title XVI, Articles 170 *et seq.*

499 See Eberlein, n. 159, p. 63.

500 For similar conclusions, see von Bogdandy in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. I, Article 3, no. 18. It seems that the Constitutional Convention working on the Treaty establishing a Constitution for Europe of 29 October 2004 (OJ 2004 C 310/1) but never ratified (and now succeeded by the Lisbon Treaty), when drafting a new Title on Energy with its Article III-256 assumed that most of the measures in the area of energy policy had been based on Article 308 EC, see G Rashbrooke, 'Clarification or Complication? The New Energy Title in the Draft Constitution for Europe', (2004) JENRL 373, 380, by referring to official documentation. This also sheds a meaningful light on the widespread insecurity that exists with respect to the powers of the EU in the area of energy policy. Article 352 TFEU, which is the successor to Article 308 EC, requires the involvement of the Member States Parliaments should it become necessary to apply this "fall back" competence. For a critical view as regards the application of this competence and the "insufficient" involvement of the national

The first and second generation internal energy market Directives are based on the "harmonization" competence of Article 95 EC and, as far as services are concerned, on Articles 47(2), 55 EC[501], which are the same provisions, on which the Commission is now basing its proposals. Article 95 EC confers upon the Community the competence to take any measures for the approximation of the laws of the Member States, which are necessary for the establishment and functioning of the internal market.[502] For this general competence to apply, it is, however, necessary that the measures envisaged abolish obstacles or distortions of competition.[503] Because it is precisely this which is the predominant objective of the Commission's proposals, Article 95 and Articles 47(2), 55 EC can be considered as a competence basis for further energy network regulation.[504]

Parliaments, see S Weatherill, 'Better Competence Monitoring', (2005) European Law Review 23.

501 Mainly due to the persistence of the Commission and the (unanimous) approval of the European Council and the European Parliament; the unanimous approval seems to be a clear sign that today it is politically recognized that EU energy policy measures can be based on Article 95 EC. Accounting for repeated demands of the Commission, *cf.* E Cross, L Hancher, P Slot, 'EC Energy Law', in M Roggenkamp, A Rønne *et al.* (eds), *Energy Law in Europe*, OUP, 2001, ch. 5, pp. 220 *et seq.* See also Rashbrooke, n. 500, p. 377. Note, however, the elaborations *infra* in the context of the new Article 194(2) TFEU.

502 As Article 95 EC is applied to the European energy sector in order to achieve the objectives set out in Article 14 EC, European energy sector regulation is not exempt from observing the four fundamental freedoms of the EC; this will become relevant further below in this chapter 3.

503 See in this respect, ECJ, C-376/98, n. 371, nos 95 *et seq.* See also, revising the case law in this area, ECJ, C-301/06 – *Ireland* v *Commission*, 10 February 2009, not yet reported.

504 Article 3(1)(h) EC, which sets out the Community activity of "the approximation of the laws of Member States *to the extent required* for the functioning of the common market" (emphasis added), is the basis for the competences in Articles 94 *et seq.* EC as regards the approximation of the (Member States') laws. "To the extent required" is to be distinguished from the necessity leg of the proportionality test of Article 5(3) EC, see Advocate General Fennelly in ECJ, C-376/98, n. 371, nos 95 *et seq.*; Tietje in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. II, Vor Article 94–97 EGV, no. 54. With respect to the Commission's proposals for the further unbundling of energy supply networks, it might be claimed that such proposals exceed what is required for the proper functioning of the common market with the consequence that the Community would not have any principal competence at all to introduce the further unbundling measures proposed. This issue is, however, not further elaborated here because it is accepted that the internal market for energy supply is not accomplished yet, that the competitive process is still to some extent distorted, and that the laws of the Member States and their respective energy supply sectors still display very diverging states of development, which still require harmonization measures at a supranational level in order for the internal energy market to function effectively and efficiently. The question, which is the focus of this work is whether the further unbundling measures proposed comply with the subsidiarity principle of Article 5(2) EC and are proportionate to the aims pursued according to Article 5(3) EC as construed by the ECJ. But this is a question to be answered by the different proportionality tests applied in the context of the enforcement of competition law, of the exercise of the competence as accepted here and of the fundamental rights issues evaluated in Part 2. Tietje, *ibid.*, nos 58 *et seq.*, argues that the subsidiarity principle is not applicable in the context of approximation measures according to Articles 94 *et seq.* EC, which apparently reflects the earlier approach of the Commission, the Council and the European Parliament,

2. ENERGY CHAPTER IN LISBON TREATY

It has just been established that currently, there is no specific competence of the EU to pursue energy policy and regulation. Consequently, the Community has to rely on the general competences for the approximation of the Member States' laws in order to achieve progress in the area of establishing an internal energy market.

The failed 2004 Constitutional Treaty made an attempt to change and clarify this rather unsatisfying situation. For the very first time, it contained its own title on energy, with far reaching competences for the European legislator.[505] These energy policy specific competences have been extended in the Lisbon Treaty.[506] In the Lisbon Treaty, Article 100(1) EC has been revised by emphasizing the area of energy in the context of difficulties arising in the supply of certain products, and Article 194 of the new energy title takes the following form[507]:

> "1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:
>
> (a) ensure the functioning of the energy market;
> (b) ensure security of energy supply in the Union;
> (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
> (d) promote the interconnection of energy networks.
>
> 2. Without prejudice to the application of other provisions of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall establish the measures necessary to achieve the objectives

for references see *ibid*. The ECJ, C-491/01 – *British American Tobacco* v Council, (2002) ECR II-2997, nos 177 *et seq*., seems, however, to accept the applicability of the subsidiarity principle, even if it uses considerations, which are to be made in the context of Article 95 EC in any event. Again, this controversy will not be decided here. As it is accepted here without further discussion that Article 95 EC is the basis of the competence for further energy network regulation, arguments with respect to the question whether and to what extent Community action is required will thus be made *infra* in the context of the subsidiarity and proportionality tests.

505 *Cf.* Article III-256 of the Treaty establishing a Constitution for Europe of 29 October 2004, OJ 2004 C 310/1, 16.12.2004. See also n. 500. Further, L Hancher, 'The New EC Constitution and the European Energy Market', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports II*, 2005, chapter 1.

506 See further in nn. 368 (and accompanying text), 495. Addition at the end of the 2nd paragraph of Article 194(2) by the author. Article 194(3) is concerned with measures of a fiscal nature.

507 Numbering of the Treaty on the Functioning of the European Union (consolidated version), see n. 495.

in paragraph 1. Such measures shall be adopted after consultation of the Economic and Social Committee and the Committee of the Regions.

Such measures shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article 192(2)(c) [currently Article 175(2)(c) EC].

3. […]."

Article 194 TFEU covers all measures, for which the Community has already legislated; the explicit competence to promote the interconnection of energy networks complements the extended competences of the Community in the area of the Trans-European Network as set out in new Article 170(2) TFEU and thus strengthens the overall competence of the EU to deal with cross-border energy network issues.[508]

V. BARS ON EXERCISE OF COMPETENCE

This section deals with possible bars or barriers to the exercise of current competences and the new competences of the TFEU in order to answer the question to what extent the Community is prevented from legislating for further energy network unbundling.

1. ARTICLE 295 EC

Article 295 EC (Article 345 TFEU) contains a bar on the exercise of competences conferred upon the EC[509], according to which the "Treaty shall in no way prejudice the rules in Member States governing the system of property ownership." Although this provision belongs to the original provisions of the EC Treaty, its exact scope is far from clear yet.[510]

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508 The competences to issue guidelines and take other measures in the area of Trans-European networks are set out in Articles 170–172 of Title XVI in the TFEU.

509 See, e.g., C Calliess, 'Ownership Unbundling für alle? – Kritische Überlegungen zu den aktuellen Entflechtungsvorgaben der Europäischen Kommission', (2007) 11 and 92, 93; Kingreen in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 295, no. 5, with further references.

510 There exists a variety of legal opinions on this subject. For an overview, see Storr, n. 35; Calliess, *ibid.*

The wording of this provision seems to support a broad applicability. The "system of property ownership", it is claimed, comprises of all constitutional provisions concerning private ownership and in particular expropriation, socialization and the regulation of the use of property.[511]

Such a *wide* interpretation does, however, neglect the fact that the EC cannot establish a common market as the predominant aim of the EC (Articles 2, 3 lit. c, 4(1) and 14 EC) without a competence to regulate the use of property. Consequently, the ECJ rejects such wide interpretation. Although the Court has not yet clarified the function and meaning of Article 295 EC, in the so-called "Golden Share" cases it has stated that the Member States' systems of property ownership are not excluded from the application of the fundamental principles of the Treaty.[512]

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511 Schweitzer in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. III, Article 295, no. 3; B Bär-Bouyssière in H von der Groeben, J Schwarze (eds), *Vertrag über die Europäische Union und Vertrag zur Gründung der Europäische Gemeinschaft*, Band 4, 6th ed., 2004, Article 295, no. 7; R Geiger, *EUV/EGV*, 4th ed., 2004, Article 295, no. 1.

512 See, for instance, ECJ, C-463/00 – *Commission* v *Spain,* (2003) ECR I-4581, no. 67; C-367/98, *Commission* v *Portugal*, (2002) ECR I-4731, no. 48; C-182/83 – *Fearon* v *Irish Land Commission*, (1984) ECR I-3677, no. 7; ECJ, C-302/97, *Klaus Konle* v *Austria*, (1999) ECR I-3099, no. 38; Advocate General Mischo in C-363/01, *Flughafen Hannover-Langenhagen I* v *Deutsche Lufthansa*, (2003) ECR I-11893, no. 38. See last ECJ, C-503/04 – *Commission* v *Germany*, (2007) ECR I-6153, no. 37. In the very recent judgement of the ECJ, C-326/07– *Commission* v *Italy*, 26 March 2009, not yet reported, Article 295 EC does not play any role because the subject-matter of this case deals with (substantively) part-privatized companies (as regards the distinction between formal and substantive privatization, see *infra* chapter 6 on the Netherlands); any possible exercise of Article 295 EC is thus subject to the EC Treaty provisions, in particular the fundamental freedoms, whose examination is the focus of this case. The rare jurisprudence of the ECJ on Article 295 prohibits the EU from taking isolated decisions about the allocation of property (see for a brief definition n. 517) and thus any formal deprivation of property rights, *cf.* ECJ, C-309/96 – *Annibaldi* v *Major of Guidonia*, (1997) ECR, I-7505, no. 22. This acknowledges the importance of the system of property ownership as a significant part of the Member States' economic constitution and social structure and the exclusive organizational power the Member States have, at least with respect to any substantial shifting of frontiers in this area. The EU competence to legislate thus extends to measures, which have a bearing on property rights, as long as they serve the Treaty's goals, in particular the completion of the internal market, and to the extend that they are not specifically targeted at reconstructing the national systems of property ownership. This case law, however, does not at all draw a clear line, see in this respect, for instance, M Ruffert, 'Zur Bedeutung des Article 295 EGV', in Henneke (ed.), *Kommunale Perspektiven im zusammenwachsenden Europa*, Boorberg, Stuttgart, 2002, p. 22, and is therefore challenged by some Advocate Generals, see, for instance, the recent opinion of Advocate General Ruiz-Jarabo Colomer in C-112/05 – *Commission* v *Germany,* (2007) ECR I-8995, nos 47 *et seq*., with respect to the participation of public shareholders in the private limited company *Volkswagen GmbH*. For further references, see also Ruffert, *ibid*., p. 20. See also further nn. 522 *et seq.* and accompanying text. This jurisprudence in particular leaves open the central question of what exactly is meant by the Member States' "rules governing the system of property ownership".

The "Golden Share" cases are referred to as support for a *narrow* interpretation of Article 295 EC.[513] According to such an interpretation, this provision is only meant as a prohibition on the Community ordering the privatization or the nationalization (socialisation) of companies. In other words, only the allocation of property in public or private ownership (for national economic policy reasons) falls outside the competences of the Community.[514]

This also seems to be the interpretation the CFI is following, which assumes a restriction of the scope of protection from Community interference under Article 295 EC, at least in cases where the Member State would not have any practical chance to run public undertakings, to participate in public undertakings or to pursue any other than mere profit-orientated considerations.[515]

It was indeed an essential motive for the Member States of the EEC at the time the Community was founded to retain the competence to decide about privatizations and nationalizations of the undertakings under their jurisdiction.[516] Midway through the 20th century, there were extensive socializations in some Member States, which it was intended the Community should not be competent to reverse.

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513 See the references in Calliess, n. 509.

514 This, it is claimed, is so because the German, French and Spanish versions of Article 295 EC, for instance, only generally refer to the system of property ownership ("Eigentumsordnung", "régime de la propriété", and "régimen de la propiedad", respectively) and not to specific property rights (rules) such as the English version, which refers to "rules […] governing […] property ownership". It is further believed that only such a narrow interpretation lives up to the ECJ's emphasis on the internal market objective and its demand to give effect to the *effet utile* of Treaty provisions. See further, Kingreen in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 295, no. 11; Calliess, n. 509, p. 94; K Hailbronner, 'Öffentliche Unternehmen im Binnenmarkt – Dienstleistungsmonopole und Gemeinschaftsrecht', (1991) NJW 593, 598; C Kahle, 'Die eigentumsrechtliche Entflechtung (Ownership Unbundling) der Energieversorgungsnetze aus europarechtlicher und verfassungsrechtlicher Sicht', (2007) RdE 293.

515 CFI, T-228/99, *Westdeutsche Landesbank Girozentrale* v *Commission*, (2003) ECR II-435, no. 195; S Storr, '"Eigentumsentflechtung", "ISO" und "Aktiensplitt" im Gefüge des europäischen Verfassungsverbundes"', proceedings of Annual Conference 2008 of Institut of Energy and Mining Law, 21 February 2008, pp. 55 *et seq*.

516 See the official explanation (motives) of the German government to Article 295, BT-Drs. 2/3440, Appendix C, p. 154. It was introduced to meet the wide-spread fear (especially in Germany) that the exercise of Treaty competences could deeply interfere with the economic order by way of adopting socialization measures whose practical implications have always been highly controversial, in particular because of the different organization of national systems of property ownership. For a concise account of the range of opinions on this issue, see Storr, n. 35, pp. 234 *et seq*., with further references, and in greater detail, Ruffert, n. 512. See also H Ipsen, *Europäisches Gemeinschaftsrecht*, 1972, ch. 41, nos 11, 18, also with reference to the extensive debates conducted in the area of the Treaties on the European Coal and Steel Community and EURATOM. *Ipsen* at the time already emphasized that Article 295 (ex 222) EC is a barrier for exercising competences rather than the basis for individual rights.

In all other cases, Article 295 EC would not have any barring effect according to this narrow interpretation. Even EC measures with expropriating effect would thus be valid without, however, questioning the principal competence of the Member States to decide about property ownership allocation according to their respective legal systems.[517] This view also refers to Article 17 of the Charter of Fundamental Rights of the European Union, which explicitly allows for expropriations.[518] This would mean that ownership unbundling and the ISO model as proposed by the Commission would not be prohibited by Article 295 EC even if they led to expropriation, as long as private property is transferred to another private party or property in public ownership is transferred to a public institution different from the one which is forced to transfer its property.[519]

It must be borne in mind, however, that the wording of Article 295 EC is clear in that it does not refer to a transfer or property from private to public ownership and vice versa. Rather, "*the system of property ownership*" in the Member States is to remain untouched, i.e. including the decision of the State to allocate property ownership; expropriation is one such decision. As a result, this provision must have a primary meaning going beyond the mere prohibition of privatizations and socializations by the Community.[520] Also, the position of this provision as part of the general and final provisions of the Treaty suggests a fundamental function, which affects all other provisions of the Treaty.[521]

Another interpretation of Article 295 EC is suggested by GA D. *Colomer* in his final pleadings in the *Golden Share* cases.[522] He argues in favour of a functional

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517 In brief, allocation of property ownership can be described as the establishment of rules governing the categories of persons who can own property subject to general constitutional principles (within a constitutional framework).

518 Kingreen in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 295, no. 11.

519 Callies, n. 509, p. 94.

520 Storr, n. 35, p. 235.

521 Advocate General Ruiz-Jarabo Colomer in the *Golden Share* cases C-367/98, n. 512, C-483/99 – *Commission* v *France,* (2002) ECR I-4781, C-503/99 – *Commission* v *Belgium* (2002) ECR I-4809, no. 44.

522 Advocate General Ruiz-Jarabo Colomer in C-367/98, n. 512, C-483/99, *ibid*., C-503/99, *ibid*., nos 49 *et seq*., in particular 54 and 65. In C-112/05, n. 512, Colomer insists in no. 48: "I continue to hold the view that the expression 'system of property ownership' contained in Article 295 EC refers not to the civil rules concerning property relationships but to the ideal body of rules of every kind, including public law rules, which are capable of granting economic rights in respect of an undertaking: in other words, rules which allow the person vested with such ownership to exercise decisive influence on the definition and implementation of all or some of its economic objectives. At the same time, the necessary purposive interpretation of the provision precludes a distinction between public and private undertakings, for the purposes of the Treaty, which is based merely on the identity of its various shareholders, and that distinction must depend instead on the opportunity available to the State to impose specific economic policies other than the pursuit of the greatest financial gain which characterises private business."

interpretation. According to his interpretation, Article 295 EC is supposed to secure the Member States' "economic rights" in respect of an undertaking. In this context, he refers to the historical interpretation. The wording of Article 295 EC goes back to a draft of the French Minster of Foreign Affairs, Robert Schumann, of 9 May 1950: "The establishment of the High Authority in no ways prejudices the system of ownership of the undertakings." Apparently, it was not the legal organization of ownership in each of the Member States that was to be shielded from the interference of the Community but the ownership of companies engaged in trading activities.[523]

The draftsmen of the Treaty proposed in December 1956 that "[t]his Treaty shall in no way prejudice the system of ownership of means of production which exists within the Community."[524] Similarly the second proposed version of January 1957: "The establishment of the Community shall in no way prejudice the system of ownership of the undertakings to which this Treaty applies."[525] This latter version was then translated into Article 83 ECSC[526], which was in force until 2002. In the EEC Treaty[527], the addition "of the undertakings" was deleted in March 1957, and the current version of Article 295 EC incorporated. It is not possible to conclude from this that the substantial function of this Article to reserve decisions of economic policy to the Member States was to be dropped. Colomer also refers to the position of this Article within the Treaty in Part VI "General and Final provisions" as well as the finality and imprecision of the expression "system of property ownership", which after all seems to indicate that it is not a legal concept but is meant as an economic concept.[528]

The ECJ has not accepted *Colomer's* perception of Article 295 EC. Without clearly stating how Article 295 EC is to be interpreted, the Court at least seems to consider the historical interpretation of only subordinate relevance. Colomer can indeed be countered in particular when looking at the wording of Article 295 EC, which does not refer to the competence of the Member States to dispose economically of property ownership (*wirtschaftliche Verfügungsmacht*) but simply to the system of property ownership in the various Member States. This is the central definitional element of Article 295 EC.

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523 Advocate General Ruiz-Jarabo Colomer in C-367/98, n. 512, C-483/99, n. 521, C-503/99, n. 521, no. 50.

524 Colomer, *ibid*., no. 51.

525 Colomer, *ibid*., no. 50.

526 Treaty establishing the European Coal and Steel Community of 18 April 1951 ("ECSC"), (entry into force on) 24 July 1952, expired on 23 July 2002.

527 Treaty establishing the European Economic Community of 25 March 1957 ("EEC"), (entry into force on) 1 January 1958.

528 Colomer, n. 523, no. 47.

An interpretation of Article 295 EC, compromising between the *narrow* and the *wide* interpretation, leads to the conclusion that the effect of this provision can only be the exemption of the core of the system of property ownership in the Member States. Such an interpretation must respect the competence of the Community to establish a common market, on the one hand, while on the other respecting that the scope of applicability of Article 295 EC should not be reduced contrary to its express wording. Legal scholarship therefore distinguishes between rights to allocate (the existence of) property ownership and rights to exercise property ownership. It construes Article 295 EC in such a way that the Community is prohibited from taking any decision with respect to the allocation of property ownership.[529] Accordingly, the Community should be prohibited from taking decisions which immediately affect the system (or existence) of property ownership[530] but not from taking decisions which affect the exercise of property ownership and which are equivalent to a restriction of the allocation of property ownership.

Following the legal opinion of *Storr*, which he has only voiced recently[531], there are two important aspects to Article 295 EC, which are of fundamental significance for any further interpretation of this provision:

First, Article 295 has a functional purpose according to which it does not protect the private law system of property ownership in the Member States as such but reinforces the economic policy competence of the Member States in the area of the law of property ownership. Advocate General Colomer is to be agreed to the extent that this provision is to ensure the neutrality of the Treaty with respect to the ownership of undertakings in an economic sense. Article 295 EC is thus to be seen as complementary to Articles 98 and 99 EC, which accord the competence for economic policy to the Member States, and to Articles 86(2) and 16 EC, which leave it to the Member States to pursue certain economic policies related to other public objectives through the operation of undertakings.[532] Article 295 EC, however, is not concerned with the competence to dispose economically of the ownership of undertakings (*wirtschaftliche Verfügungsmacht*) but simply with the "system of property ownership in the various Member States".

Secondly, Article 295 EC is not concerned with the system of property ownership as guaranteed by EC law but with the rights of property ownership as granted by

529 Schmidt-Preuß, n. 241, p. 475. For a brief definition of "allocation of property ownership", see n. 517.

530 Koenig/Kühling in Streinz, EUV/EGV, 2003, Article 295 EGV, no. 13.

531 Storr, n. 515.

532 S Storr, *Der Staat als Unternehmer*, 2001, p. 301, and Storr, n. 35, p. 235.

national law. This can be inferred from the wording of Article 295 EC, which is not aimed at the European right to property but which leaves the system of property ownership "*in* the Member States" untouched. In the context of this work, the Dutch and the German version of this provision read similarly: "Dit Verdrag laat de regeling van het eigendomsrecht *in* de lidstaten onverlet" and "Dieser Vertrag lässt die Eigentumsordnung *in* den verschiedenen Mitgliedstaaten unberührt".[533] This wording also deviates significantly from the wording of Article 6(2) EU, which refers to the "constitutional traditions *common* to the Member States".[534] Article 295 EC thus turns out to be one of the core provisions of the European "multilevel constitutionalism" (or "union of national constitutions" or *Verfassungsverbund*)[535] in that it refers to the Member States' legal systems.[536]

Consequently, having established that Article 295 EC is supposed to ensure that fundamental decisions of economic policy stay in the remit of the Masters of the Treaty, i.e. the Member States, and that the national systems of property ownership are to be left untouched, the fundamental decisions to nationalize or socialize private sector market activity or, *e contrario*, to privatize public sector market activity fall within the competences of the Member States and not the EU. As measure of principal property ownership allocation, such decisions consequently are not subject to the Treaty rules and thus the fundamental freedoms such as Article 56 EC.[537] Article 295 EC therefore prohibits any

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533 Emphasis added.

534 Emphasis added.

535 Understood as interactive reciprocal influence and complementary to the Member States' and EU constitutional law, see Huber in VVDStRL, *Europäisches und natinales Verfassungsrecht*, Vol. 60, 2001, pp. 194, 226 *et seq*., or as normative entanglement and functional fusing, see Pernice in VVDStRL, *Europäisches und natinales Verfassungsrecht*, Vol. 60, 2001, pp. 148, 164.

536 Storr, n. 515. This might appear rather impracticable and overly complex given that there are 27 Member States and thus as many legal systems but in the early years after the Treaty entered into force this was consistent because the theoretical basis of property rights in the Member States is the fundamental right to property as guaranteed in these Member States. Further, an EC fundamental right to property was not in place at the time, and was not established until its recognition by the ECJ in 1974 and 1979 in re *Nold* (C-4/73, (1974) ECR 491) and in re *Hauer* (C-44/79, (1979) ECR 3727), respectively.

537 To exclude the Member States' right to alocate property ownership from the application of the Treaty rules does not contradict the ECJ's case law according to which the Member States' systems of property ownership are not excluded from the application of the fundamental principles of the Treaty. First, this case only seems to be directed against the exercise (and not the allocation or existence) of property ownership, which is reflected in the subject-matters of the *Golden Share* cases. Any measures protected by Article 295 EC as understood here can thus never be in breach of the Treaty rules, a fact, which the ECJ has so far not dealt with. The ECJ case law so far concerned the exercise of property ownership, which is in an established conflict with the Treaty rules. The guaranteed core of the right to property (*Wesensgehalt*), see further *infra*, as a fundamental right can never be in conflict with the Treaty. What is more, it

decisions of the Community to nationalize, socialize or privatize. This argument is supported by the fact that the EC does not distinguish between public and private undertakings as market actors, which is an indication that the EC is not interested in shifting undertakings into the private or public sphere. As soon, however, as such a fundamental decision has been taken such as would be the case in situations of part or minority privatization, i.e. in the sphere of property ownership allocation, or as soon as the fundamental decision as to privatization of any kind has taken place and been enforced, property ownership has been allocated and the exercise of property ownership comes into the focus and falls under the Treaty provisions, in particular under Article 56 EC.

This interpretation also finds support in the Treaty of Lisbon. Although, for the first time, the EU will explicitly obtain a competence for energy in the new Article 194 TFEU (see below), the Article's 2nd subsection provides for the exclusive competence of the Member States to determine "the general structure" of their energy supply.[538]

These conclusions do not, however, mean that the entire national system of property ownership can be relevant. In an increasingly integrated European "union of national constitutions" (*Verfassungsverbund*)[539], the constitutional traditions of the other Member States and the development of the law in the European Union have to be taken into account when interpreting Treaty provisions. As it is one of the main tasks of the Community to establish a functioning internal market, the area of application of Article 295 EC must therefore be adjusted accordingly. It is therefore only logical to reduce the scope of Article 295 EC to an "integration resistant" core consisting of the national guarantee of property ownership.[540]

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is alleged that vertically integrated energy network ownership is in conflict with the Treaty rules, but this has, however, never been established to date. Lastly, the ECJ ruled in the context of existing national legislation which is in a completely different context to the measures discussed here. The measures discussed here are the subject of legislation currently about to be passed on European level (i.e. not yet in existence) which has as its objective to detach allocated energy network ownership from its vertical integration so as to remedy its alleged breach of Treaty rules.

538 See further in section V(3) *infra*.

539 See, e.g., U Di Fabio, 'Grundfragen der europäischen Eigentumsordnung', in W Löwer, *Bonner Gespräch zum Energierecht*, Band (Volume) 1, 2006, pp. 9 *et seq.*; further, Storr, n. 35, 235; Schmidt-Preuß, n. 241, p. 475, and 'Verfassungsrechtliche Rahmenbedingungen des Unbundling', in J Baur, K Pritzsche, S Simon (eds), *Unbundling in der Energiewirtschaft*, 2006, ch. 2, no. 68.

540 Storr, n. 35, 235; J-C Pielow, E Ehlers, 'Rechtsfragen zum "Ownership Unbundling"', (2007) IR 259, 262.

This interpretation of Article 295 EC is reflected in a concept of cooperation[541], which runs through the entire Treaty, exemplified by the duty of loyalty in Article 10 EC, the obligation of the EU in Article 6 EC to respect the national identities of the Member States, the subsidiarity (and the proportionality) principle of Article 5(2) and (3) EC and finally, constitutional safeguards in the Member States; for Germany, for instance, a constitutional safeguard exists in Article 79(3) of the German Constitution Grundgesetz (GG)[542] for the core principles of the Grundgesetz, to which the "integration clause" in Article 23 GG refers.[543]

Given, however, the ever growing fundamental rights protection on the EU level, exemplified by the European Charter of Fundamental Rights and its incorporation into the Lisbon Treaty, this argument can be taken further to the extent that Article 295 EC also disallows community legislation, which encroaches upon the essential content (*Wesensgehalt*) of the fundamental right to property, which all Member States' constitutions throughout the European Union have in common.[544] The untouchable core of the right to property in the Member States' constitutions and under EC law is similar in structure[545] and, apart from differences in detail, the constitutions of all Member States allow for, explicitly or implicitly, the expropriation and the regulation of property.[546] As sources of the European order of fundamental rights (see Article 6 EU) they, together with the ECHR, characterize the EC law fundamental right to property. Explicitly, Article 17 ECFR[547], which is to be included in the Lisbon Treaty, provides for the right to

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541 To this extent also prominently the BVerfG in its seminal *Maastricht* decision, see n. 99 (BVerfGE 89, 155).

542 Grundgesetz für die Bundesrepublik Deutschland of 3 May 1949 as amended.

543 See Storr, n. 515. See the corresponding reference in Article 23(1) 3rd sentence GG to Article 79(3) GG, which is also called eternity clause meaning that no parliamentary majority can change certain constitutional principles. To some extent similar to Germany albeit enforced by completely different means of law, the UK, which, being a dualistic constitutional system like Germany, safeguards its (non-codified) constitution by way of the overarching principle of "Sovereignty of Parliament", which basically means that the current Parliament cannot bind future Parliaments; *e contrario*, this means that unless judge-made common law changes, parliamentary democracy cannot be abolished in the UK. For an excellent account of this predominant principle of state organization in the UK, see A Tomkins, *Public Law*, OUP, 2003, pp. 102 *et seq.* The Netherlands, as monistic constitutional system, does not possess such a mechanism, which can be inferred from an *e contrario* conclusion drawn from Article 91 Dutch Constitution *Grondwet*.

544 Storr, n. 35, 235; 'Der Wandel der Energiewirtschaft vor dem Hintergrund der europäischen Eigentumsordnung', in W Löwer (ed.), *Bonner Gespräch zum Energierecht*, Band (Volume) 1, 2006, pp. 51 *et seq.*

545 Storr, n. 515.

546 For references to the corresponding Member States' constitutional laws, see Storr, n. 515; S Heselhaus, 'Eigentumsgrundrecht', in S Heselhaus, C Nowak, *Handbuch der Europäischen Grundrechte*, 2006, § 32 nos 22 *et seq.*; Depenheuer in Tettinger/Stern, Article 17, pp. 432 *et seq.*

547 Debenheuer, *ibid.*

possess, use and dispose of lawfully acquired property, and it distinguishes between expropriation as deprivation of property in the public interest, in return for compensation[548], and the regulation of the use of property to the extent necessary for the benefit of the general public, which, however, may not violate the essential content (*Wesensgehalt*) of the right to property. Consequently, the *Wesensgehalt* as core of the right to property is protected.[549]

Accordingly, Article 295 EC prevents the Community from substituting ownership with something, which does not deserve to be called "ownership" any longer[550], or in other words, the "untouchable" core of the guarantee to own property may not be undermined.[551] Hence, in order to define the scope of Article 295 EC, the *Wesensgehalt* of the right to property within the European "union of national constitutions" needs to be explored.

In brief, according to the German Federal Constitutional Court[552], the *Wesensgehalt* of the right to property consists of the allocation of a particular property to a particular owner (so-called *Privatnützigkeit*) in order for it to be available for his economic use and benefit on the one hand, *and*, on the other hand, to give him the principal power to dispose of such property (*Verfügungsbefugnis*).[553] The power to dispose of his property does not only include the positive power for the owner to do with his property whatever he pleases but also the (negative) power, not *to have* to dispose of it; the power to dispose thus reflects the control, or better, the sovereignty over the property.[554]

As can be inferred from the outline of the unbundling measures envisaged by the Commission in the Introduction, the measures would considerably impact the

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548 Expropriation is the most intrusive interference with ownership and thus principally carries the obligation to pay compensation, no matter whether vertically integrated energy supply undertakings receive the market value (after a forced sale) or compensation for the expropriation because this is only a financial compensation, which does not alter the complete deprivation or *de facto* expropriation of the power to dispose of the property on its own volition.

549 See C Calliess, 'Eigentumsgrundrecht', in D Ehlers (ed.), *Europäische Grundrechte und Grundfreiheiten*, 2nd ed., 2005, § 17, p. 475.

550 For Germany, this was, for instance, decided by the BVerfG in BVerfGE 24, 367, 389, in the context of the guarantee of the *Wesensgehalt* of the right to property.

551 The substance of ownership must be preserved, see BVerfG in BVerfGE 79, 174, 198, and BVerfGE 100, 226, 241 – *Denkmalschutz*.

552 Reference is made to the case law of the BVerfG, the German Federal Constitutional Court, because the right to property, apart from its basic features and the recognition of its essential substance, is not developed in equal breadth and depth throughout the European Union. The BVerfG, however, can be considered to be at the forefront of the development of fundamental rights theory.

553 BVerfG in re *Denkmalschutz*, n. 551, and in BVerfGE 87, 114, 138.

554 BVerfG in BVerfGE 53, 257, 291.

Privatnützigkeit and power of disposal of the energy network assets. Ownership unbundling as envisaged by the Commission could only be enforced by way of imposing an obligation in law to sell and/or (in case of failing to do so) the expropriation in favour of the State or private third parties. In whatever way the transfer of the network assets (or the remainder of the vertically integrated energy supply undertaking) is mandated, at the end of the day, the intended result will be the deprivation of property leading to a complete loss of the right to and the possession of the property.

As will be shown in greater detail in Part 2 of this work in the context of analysing the fundamental rights protection in Germany, the UK, the Netherlands and the EU, ownership unbundling by way of a forced sale and/or (complete) deprivation of property can either be viewed as an outright expropriation and/or a deprivation of property, which amounts to a *de facto* expropriation.[555]

The proposed special variant of ownership unbundling, the so-called share split, which was outlined in the Introduction, does not alter the fact that owners are deprived of their property by way of expropriation or at least of *de facto* expropriation.[556] The share split not only splits the vertically integrated energy supply undertaking into two parts thereby expropriating the legal person of the undertaking but by also demanding the sale of one of the two shareholdings (resulting from the share split), should one of the two shareholdings be a controlling stake, this amounts to an expropriation or at least *de facto* expropriation of the shareholders.

Consequently, the proposed measures of ownership unbundling and share split would both, if enacted, be in breach of Article 295 EC. The Community may thus not exercise its competence to regulate energy supply networks in the EU in order to introduce those two further unbundling measures.[557] This is so even if lawful alternative unbundling measures are introduced at the same time because it would breach the rule of law, according to which institutions with sovereign powers have to act in accordance with the law; a Directive to this extent would thus be partially invalid.

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555 Under German law, the latter would be classified as a regulation of property (*Inhalts- und Schrankenbestimmung*) amounting to expropriation, see BVerfG in re *Denkmalschutz*, n. 551. For an exact distinction between deprivation, expropriation and regulation of property, see Introduction and Part 2 *infra*.

556 See also in greater detail Part 2 *infra*.

557 But see, in this regard, n. 504 and n. 596 and accompanying text at section VI *infra*.

As regards the ISO model proposed as an alternative unbundling measure by the Commission[558], the power to dispose of the network assets to some extent remains with the network owner, although on an alternative view (i.e. in particular as regards the control of the networks, which is inherent in the power to dispose) the power to dispose is lost to the ISO. Further, by having to transfer the operation of the networks to the ISO, the *Privatnützigkeit* of the network assets to the network owner is considerably inhibited. Here also, with respect to the question of whether Article 295 EC is to be seen as a bar to introducing the ISO model as part of energy supply network regulation, the question arises whether the extent to which the *Privatnützigkeit* of the network owner (to make a profit from its property, the energy networks and their operation) is restricted, amounts to an expropriation of network property. This mainly depends on whether the network owner receives an adequate allowance (to include some profit margin) as a compensation for the loss of control over (operation of) its networks, for putting capital (consequent on its obligation to ensure sufficient quality of the networks) and network assets at the disposal of third parties. Although it will be argued in Part 2 *infra* that the ISO model as proposed by the Commission indeed amounts to a (*de facto*) expropriation of network property[559], this is not *per se* the case, in contrast to ownership unbundling and share split. Thus, it can be said that in principle, the Community is allowed to introduce independent system operation, i.e. pursued by third parties independent from the vertically integrated energy supply undertaking and the integrated network owner, as long as the *Privatnützigkeit* of the energy network owner is not abolished altogether. If the *Privatnützigkeit* is safeguarded by the ISO model, it is simply a permissible regulation of (network) property.[560]

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558 See in the Introduction.

559 The network owner loses control of and the power to dispose of and use its existing networks (incl. the power to decide over the *necessity* of investments) and any investment he pursues; if third parties invest he would have to concede the decision to *carry out* the investment to third parties). Further, an adequate return is questionable as this is likely to be regulated (or at least controlled by a sector regulator). Network owners are downgraded to mere service providers on their own grids, which does not give them any economic benefit from the use of their property but only from their economic activity as service provider. The ECtHR has articulated in *Katte Klitsche de la Grange* v *Italy*, 27 October 1994, Ser. A 293-B, that "[w]here […] the owner retains the ownership subject to restrictions which reduce to virtually nothing the economic value of the use or exchange of the property, this is known as "value expropriation" and it gives rise to an entitlement to compensation. This situation arises where the restriction is very severe – absolute prohibition – and where it is imposed for an indefinite period of time or remains in force for longer than is reasonable." See also n. 1161 .

560 See in greater detail Part 2.

2. ARTICLE 175(2)(C) EC

Another bar for the Community to the exercise of its competence to regulate energy supply networks in the EU or, better, a restriction could possibly be seen in Article 175(2)(c) EC, according to which measures, which "significantly" affect the "general structure" of national energy supply, require as an exception to the rule of qualified majority the unanimous decision of the Council.

Article 175(2)(c) EC, however, is part of Title XIX on "Environment".[561] It thus can only be applied to measures with respect to the structure of energy supply, which are motivated by environmental policy objectives. The Commission proposals of September 2007, however, have as their main objective to enhance competition in the internal energy market.[562]

As part of an explicit Treaty Title, which confers specific competences onto the Community, its applicability in the context of harmonization measures based on Article 95 EC is also questionable. Nevertheless, the existence of this provision indicates that measures, which touch upon the Member States' general structure of energy supply, have to be met with reservations. With respect to the question whether "the general structure of energy supply" also includes the vertical structure of the energy supply sector has not been answered yet. So far, this issue has only become relevant in the area of environmental policy, in particular with regard to the composition of primary energy resources to be used for electricity generation in the Member States.[563]

The inclusion of the vertical structure of the energy supply sector into the meaning of the term "general structure of energy supply" seems to have played a role in the context of the drafting of the new Title on energy policy to be introduced when the Lisbon Treaty enters into force, more particularly in the new Article 194 TFEU[564], which is discussed below.

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561 The Lisbon Treaty, n. 300, would move the Title on 'Environment' to Title XX, and Article 175(2)(c) EC would become Article 192(2)(c) TFEU, keeping its wording.

562 See in this respect also Lecheler, n. 466, who rightly notes that the factual basis, on which the Commission bases its assertion that competition in the internal energy market works inadequately, is of a rather doubtful nature. The factual basis Lecheler is referring to can only mean the Impact Assessment of the September 2007 proposals, n. 15, and the results of the energy sector inquiry, n. 3, which are based on 2005 figures. Lecheler also reviews the other components of Article 175(2)(c) EC such as the unanimity requirement.

563 As regards background and content of Article 175(2)(c) EC, see Kahl in Streinz, EUV/EGV, 2003, Article 175 EGV, nos 28 *et seq.* with further references, and Pielow/Ehlers, n. 35.

564 See nn. 495, 506.

3. ARTICLE 194(2) LISBON TREATY

Unlike Article 175(2)(c) EC, Article 194(2), 2nd sentence TFEU is straightforward in stating that measures taken in the area of energy policy "shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, […]."

The first observation to make when analysing this new provision is that the Member States' right is exclusive and cannot be overturned even if the Council decided unanimously. Secondly, vertical integrated energy supply, it is submitted, is indeed part of the "general structure of energy supply", which is not subject to the harmonization powers of the Community (but obviously still subject to the competition law provisions of the Treaty), and which leaves its determination entirely and exclusively to the Member States.[565] Vertical integration is assumed here to be included because in leaving to the Member States the decision on the way energy is supplied, it must also be left to their legal, economic and political judgement, to determine under which corporate structure this supply is supposed to be organized.[566]

4. ARTICLE 56 EC

Another issue to consider in the context of introducing further unbundling measures on the basis of Article 95 EC is that its application must serve the attainment of the goals set out in Article 14 EC, and thus the fundamental freedoms of the internal market.[567] The fundamental freedoms do not only bind the Member States but also, as can be inferred from Articles 3(1), 7(1) and 249(1)

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565 Any measures taken under Article 194 EC may thus not interfere with vertically integrated energy supply on the national level; only the Member States themselves are allowed to take such measures (of their own volition). Not even the procedure of the new Article 352 TFEU (ex Article 308 EC) can be applied here because this is not about a lack of competences but about the explicit exclusion of such competence. Article 194 TFEU appears to be a sort of *ex tunc* approval of all the measures taken so far by the Community in the area of energy policy, see already n. 506 and accompanying text. However, the explicit mention of the exclusive competence of the Member States to determine the general structure of their energy supply seems to indicate that the prescription of ownership unbundling of the energy networks as the only possible measure which would finally and definitely dissolve the vertical structure of energy supply, is a competence which the Member States did not want to entrust the Community with. This position would also confirm the stance taken *supra* with respect to the interpretation of Article 295 EC.

566 This does, however, not mean that the current state of unbundling can be rolled back because it belongs to the *acquis communitaire*, which has been approved by the Member States.

567 See again ECJ, C-376/98, no. 371, nos 83 *et seq.*

EC, the EC legislature, even with respect to legislation based on the approximation and harmonization competences of Article 94 *et seq.* EC.[568]

To a lesser extent than the Commission's proposals of September 2007, the Council of Energy Minister of the Member States in its common position of 9 and 10 October 2008 suggests that "companies engaged in the production or supply of gas or electricity [should be prohibited] from exercising control over a transmission network operator of a Member State that has opted for full unbundling."[569] This would mean that energy generation or production and supply undertakings (i.e. not including TSOs) whether vertically integrated or not, would either have to give up their (shareholdings in) energy transmission network owning TSOs in Member States, which have opted for ownership unbundling or not be allowed to acquire such interests or control. Similar to ownership unbundling, this would mean that existing transmission network operation activities would have to be sold or that such generation/production and supply undertakings would be prevented from establishing and carrying on an economic activity in the area of transmission networks in Member States, which have opted for ownership unbundling.[570]

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568 See Schroeder in Streinz, *EUV/EGV*, 2003, Article 28, no. 29; Tietje in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. II, Vor Article 94–97 EGV, no. 53.

569 See Council of the European Union, nn. 372 *et seq.* and accompanying text, also with regard to the Commission's proposals of September 2007. Article 9(12) of the draft Electricity and Gas Directives as approved by the European Parliament on 22 April 2009, nn. 31, 33, 95, 372, 426, contain a similar wording. Such undertakings are also not allowed to own transmission networks in such Member States. The draft Energy Directives do not refer to vertically integrated companies in this context any more which contrasts with the more far reaching intentions expressed by the Commission in its original proposals, see n. 375 and accompanying text. Thus, vertically integrated TSOs (not vertically integrated generation/production and supply undertakings!) in Member States which opt for the ISO or the ITO alternatives seem to be able to control TSOs or own transmission networks in Member States which have opted for ownership unbundling.

570 Further unbundling measures initiated by EC legislation might infringe the EU's obligations arising from its ratification of the Energy Charter Treaty, more particularly from its Article 13. The investment regime of the Energy Charter Treaty (ECT), n. 96, covers both pre-investment and post-investment phases with the latter providing enforceable obligations of the signatory states. EU Member States' investors in the energy (supply) sector enjoy protection under the ECT as regards their shareholdings in other EU Member States, see C Bamberger, T Wälde, 'The Energy Charter Treaty', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, chapter 3, no. 3.16, and more generally, T Wälde, 'International Investment under the 1994 Energy Charter Treaty', (1995) JWT 5, and can directly sue the for breach of the Treaty's post-investment obligations under its Part Three by way of arbitration under Article 26 ECT, or before the courts of the contracting party where the investment is situated. State-state arbitration is also possible according to Article 27 ECT. The obligation to pay compensation for expropriation is also set out in Article 13. As regards the different forms an expropriation may take and the inconsistent terminology used and the varying definitions for expropriation, see C Redgwell, 'International Regulation of Energy Activities', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, chapter 2, no.

The Council's common position (and even more the Commission's position of September 2007) might run into conflict with two EC fundamental freedoms, the free movement of capital according to Article 56 EC and the freedom of establishment according to Article 43 *et seq.* EC.[571]

The ECJ made it clear that the free movement of capital, as a fundamental principle of the Treaty, may be restricted only by rules which are justified by reasons referred to in Article 58(1) EC or by overriding requirements of the general interest. Furthermore, in order to be so justified, national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality.[572] The Court further stressed that the requirements of public *policy* and *security*, as with every derogation from the fundamental principle of free movement of capital allowed in Article 58(1)(b) EC, must be interpreted narrowly.[573] Thus, public policy and public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society,

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2.222. As regards the need for an expropriation to be in the public interest, it also appears that this is the only test which applies as the proportionality of expropriation hardly seems to be an issue. See in greater detail, Redgwell, *ibid.*, no. 2.224, with further references. Compensation is supposed to amount to the payment of the market value of the investment immediately before the expropriation (or before it became public knowledge), see Redgwell, *ibid.*, nos 2.224–5. See T Wälde, A Kolo, 'Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law', (2001) ICLQ 811, with respect to *de facto* expropriation under the ECT.

571 With respect to the concurrence of the two fundamental freedoms at issue here, i.e. Articles 56 (for instance, with respect to controlling shareholdings as direct investment) and 43 EC (for instance the establishment of a subsidiary in another Member State), both are in principle applicable. However, what can be inferred from Articles 43(2) and 58(2) EC is that activities relevant under both freedoms are covered by the level of protection as laid out in Article 56 EC, only the scope of the restrictions of the fundamental freedoms are extended in that lawful restrictions of both freedoms are applicable. In the context given, only the restrictions in the context of the free movement of capital are relevant; thus, the freedom of establishment will not be further assessed here. As to the priority or independency of the examination of Articles 43 and 56, see also ECJ, C-326/07, n. 512, nos 34–36.

572 See, e.g., ECJ, C-503/99, no. 521, no. 45, and C-174/04 – *Commission* v *Italy*, (2005) ECR I-4933. On the application of the proportionality test in the current context, see ECJ, Joined Joined Cases C-163/94, C-165/94 & C-250/94, *Sanz de Lera and Others*, (1995) ECR I-4821, no. 23, and C-54/99 – *Église de scientology* v *The Prime Minister,* (2000) ECR I-1335, no. 18.

573 According to the ECJ, *public policy* means sovereignly established fundamental rules, which affect the fundamental interests of the State, see ECJ, C-30/77 – *Régina* v *Bouchereau*, (1977) ECR I-1997, 2013. Any derogation on grounds of *public policy* and/or *public security* is only permissible if there is a genuine and sufficiently serious threat to *public policy*, see ECJ, C-36/75 – *Rutili* v *Ministre de l'Interieur*, (1975) ECR 1219, whereby such a threat must affect the fundamental interests of the State. *Public security*, which is a particular part of *public policy*, is concerned with fundamental interests of the State such as the safeguard of the continuance of fundamental public services or the safe and effective functioning of the operation of the State, i.e. the safeguard of the existence of a Member State against internal and external interferences, see ECJ, C-72/83 – *Campus Oil* v *Minister for Industry and Energy*, 1984) ECR I-2727, 2751.

such as supply security in the event of crisis.[574] In this context, the ECJ has recognized that the State can interfere with the economic activity of undertakings, which render services of general interest or which are of strategic importance, such as energy supply undertakings.[575]

Only if no reasons referred to in Article 58(1) EC are applicable, do the overriding requirements of the general interest as a restriction immanent to Article 56 EC come into play.

The ECJ has so far only recognized such overriding interests on a case-by-case basis, in matters such as consumer or environmental protection.[576] It is widely claimed that only general interests of non-economic character can be overriding restrictions.[577] This seems to be confirmed by the case law of the ECJ, which has so far only recognized non-economic interests.[578] What is true in this respect at the least is that protectionist measures (or any other economic measures disallowed under the Treaty or contrary to the aims of the Treaty) are not justified.[579] Further, the ECJ has explicitly not recognized the strengthening of

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574 See ECJ, C-54/99, n. 572; C-483/99 – *Commission* v *France*, (2002) ECR I-4781, no. 48; C-503/99, n. 521, no. 48; C-463/00, n. 512, no. 72; C-274/06 – *Commission* v *Spain*, 14 February 2008, no. 39 (summary reported in (2008) ECR I-26); ECJ, C-207/07 – *Commission* v *Spain*, 17 July 2008, no. 47 (not yet reported). A civil court in the Hague in the Netherlands has recently ruled that energy supply reliability (i.e. reliability of energy transport) generally is to be regarded as a public policy reason (which the court also relates to consumer protection, see further n. 576 and accompanying text), not only in times of crisis, see Rechtbank 's Gravenhage, *Delta N.V. tegen De Staat der Nederlanden*, no. 293142 / HA ZA 07–2538, 11 March 2009. This, however, is in clear contradiction to the just mentioned ECJ case law, which accepts energy supply security (i.e. sufficient availability of energy) and then only in times of crisis as public security reason.

575 See, e.g., ECJ, C-503/99, n. 521, no. 45, and C-367/98, n. 512, no. 47.

576 For the latter, see, for instance, the recent judgement by the EFTA Court, E-2/06 – *EFTA Surveillance Authority* v *Norway*, (2007) EFTA Court Reports 167, nos 79, 81. Contra to the Dutch court ruling, see n. 574, it is questionable whether reliability of energy transportation serves the protection of consumers; only the safety of appliances at the consumer premises where such transport ends would seem to related to consumer protection. As to the definition of consumer protection, see n. 591 and accompanying text.

577 See, for instance, Ress/Ukrow in Grabitz/Hilf, *Das Recht der Europäischen Union*, Kommentar, Bd. II, Article 56 EGV, no. 77, and Article 58, no. 3; R Streinz, *Europarecht*, 8rd ed., 2008, no. 833.

578 Although it can be said that often economic general interests have a non-economic aspect, such that, for example, the functioning of the (internal) market and undistorted competition as economic general interests and original goals of EC integration also serve the functioning of the economy and thus society as a whole, which is a non-economic general interest, economic general interests have never been recognized by the ECJ as overriding restrictions of fundamental freedoms.

579 ECJ does not allow Member States to avoid the effects of Treaty measures by invoking economic difficulties, which arise as a consequence of the elimination of obstacles to the internal market, see, for instance, ECJ, C-72/83, n. 573, no. 35; see also P Wilmowsky, 'Freiheit

the competitive structure of the market as a valid basis for an overriding restriction.[580] Moreover, it is submitted that non-economic overriding general interests should not be taken into account merely because they may be ancillary to primarily economic general interests, or consequential thereon because otherwise the principle established by the ECJ that restrictions of fundamental freedoms are to be narrowly construed would be infringed and non-economic general interests would be artificially deemed to be associated with economic general interests simply to validate an economic general interest as a basis for applying it as a restriction.[581]

The EU invokes the improvement of competition in the internal energy markets in order to achieve energy supply security in the long-term as public *security* reason (in accordance with Article 58(1)(b) EC) for introducing further unbundling.[582] Further, the achievement of greater market transparency in order to enhance consumer protection through greater market transparency has, for instance, been relied upon by the UK, as well as the improvement of competition in the markets in order to achieve greater environmental protection, such as a more effective emission trading scheme, and easier and non-discriminatory market access of renewable energy sources (RES) and combined heat and power (CHP) in order to fight climate change.[583] All these aims may possibly be

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des Kapital- und Zahlungsverkehrs', in D. Ehlers (ed.), *Europäische Grundrechte und Grundfreiheiten*, 2nd ed., 2005, § 12, pp. 343–350.

580 See ECJ, C-174/04, n. 572, where the Court upheld its earlier findings in C-367/98, n. 512, no. 52, that "an interest in generally strengthening the competitive structure of the market in question cannot constitute valid justification for restrictions on the free movement of capital.

581 Particularly prohibited is the abusive reliance on reasons of public security and policy if such reasons are detached from their actual function and in fact invoked for economic purposes, see ECJ, C-54/99, n. 572, no. 17, and C-503/99, n. 521, no. 47.

582 See Recital 14 of the Commission's proposals for Electricity and Gas Directives of 19 September 2007: "The safeguarding of energy supply is an essential element of public security and is therefore inherently connected to the efficient functioning of the EU electricity market. Functioning electricity and gas markets and in particular the networks and other assets associated with electricity supply are essential for public security, for the competitiveness of the economy and for the well-being of the citizens of the Community. Without prejudice to the international obligations of the Community [such as the European Energy Charter Treaty], the Community considers that the electricity transmission system sector is of high [i.e. strategic] importance to the Community and therefore additional safeguards are necessary regarding the influence of third countries in order to avoid any threats to Community public order and public security and the welfare of the citizens of the Community (comments added)." Considerations relating to non-EU countries are not further analysed here.

583 See Part 2 Chapter 5 on Great Britain. The UK, however, has failed so far to live up to such aims. C Mitchell, D Bauknecht, P Connor, 'Effectiveness through risk reduction: a comparison of the renewables obligation in England and Wales and the feed-in system in Germany', (2006) Energy Policy 297, have established that the German support mechanism albeit less efficient in the short-term and thus promoting less the competitive incentive to keep prices down, is more effective at increasing the share of electricity generation from renewable energy sources

classified as overriding restrictions in the general interest of Article 56 EC.[584] Reciprocity and the protection of the national energy supply industries, both irrelevant objectives under Article 56 EC, are also reasons, which are likely to have played a role in helping the Council to settle a common position on 9 and 10 October 2008.[585]

(RES) and thus more conducive to provide long-term security of electricity supply leading to efficiency improvements in the long-term. The support scheme for electricity generation from RES in England and Wales (which is similar to the system applied in Scotland) is based on so-called renewable obligation certificates proving compliance with the obligation to supply a certain volume of electricity produced from RES. In Germany, to the contrary, a so-called feed-in tariff support scheme is applied according to which electricity network operators are obliged to connect electricity generation from RES and pay such generators a certain surcharge for the electricity they feed into the system. See in greater detail also Brunekreeft/Ehlers, nn. 8, 38.

584 The European Commission describes the general interest its proposals of 19 September 2007 are supposed to serve in its Explanatory Memorandum as follows: "a competitive and efficient electricity and gas market is a pre-condition to tackle climate change [and is] crucial to ensure the security of Europe's energy supply, as only a Europe-wide and competitive market generates the right investment signals and offers fair network access for all potential investors, and provides real and effective incentives to both network operators and generators to invest the billions of Euros that will be needed in the EU over the next two decades. […] Well-functioning retail markets will also play a very important role in increasing people's awareness of domestic energy consumption and the cost of energy. Competition over supply to households will enhance people's energy-awareness. Suppliers therefore need to give more information to ensure that customers get more frequent information on their energy consumption and costs." It should be noted, however, that competitive markets are economic general interests, and that they serve as one, and not the only, precondition to tackle climate change as can be inferred from the EC legislation already in place such as support mechanisms for RES and CHP, see in this regard already Ehlers, n. 7. Functioning Europe-wide and competitive markets are the direct and economic goals of the legislation proposed here, whereas supply security is "only" the indirect goal to be achieved after functioning markets have been achieved. Competition and market integration as the Treaty's original goals are in principle legitimate general interests and the fundamental freedoms are there to achieve them. On the other hand, it has been established that in the context of restricting fundamental freedoms, these general interests do not seem to be admissible as they would restrict what the fundamental freedoms are supposed to promote. The question whether only EU-wide and competitive markets generate the "right" investment signals is questionable given that renewable energy sources whose promotion is a major goal of the EU's energy policy are still not competitive and still require support mechanisms, which are already in place. Further, it has so far not been sufficiently proven that network access is not fair. What is more, it has turned out that tackling sufficient network investment is of much lesser urgency than tackling investment in generation. Empirically, however, it is not clear that further unbundling is tackling this issue, see Brunekreeft, EPRG and UNECOM, n. 9. With respect to functioning retail markets, as has already been established, this is not a goal accepted by the ECJ in the context of restricting Article 56 EC. Further unbundling is, however, not necessary to enhance the information customers get about their energy consumption and costs.

585 See n. 31. As regards the issue of creating a so-called *level playing field*, see already chapter 1 section III in the context of the alleged problem of cross-subsidization.

Invoking supply security as valid public security restriction according to Article 58(1) EC to justify further unbundling legislation might, however, conflict with what has been established by the ECJ. In *Commission* vs *Belgium*[586] the ECJ accepted supply security as a valid public *security* restriction (Article 58(1)(b) EC) of Article 56 EC only because the legislation was specifically targeted at events of energy crisis[587], i.e. where supply security was under immediate threat, occurring in narrowly prescribed circumstances and not across-the-board and restricting fundamental freedoms permanently[588], and subject to judicial review. The mere acquisition of shareholdings in undertakings, which pursue certain activities in the energy sector, which are subject to regulation, and the acquisition of assets necessary for such activities, are not as such to be regarded as genuine or sufficiently severe threat to the security of energy supply.[589]

Further unbundling legislation is primarily aimed at enhancing the competitive structure and thus the functioning of the energy markets in order to attract investment, which is supposed to safeguard supply security in the long-term, but it is not merely targeted at ensuring that supply security does not fail in the event of an immediate threat. The legislation is thus based on an economic general interest, which in addition has already been refused by the ECJ in *Commission* vs *Italy*.[590] The public *security* general interest of supply security (and economic goals such as greater transparency in the markets) are not to be achieved directly

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586 See, e.g., ECJ, C-503/99, n. 521. There, the ECJ states that "[t]he objective pursued by the legislation at issue is the safeguarding of energy supplies in the *event of a crisis*. It has previously been recognised that the public-security considerations which may justify an obstacle to the free movement of goods include the objective of ensuring a minimum supply of petroleum products at all times (*Campus Oil*, paras 34 and 35). Thus, these are legitimate grounds of justification referred to in Article 58(1)(b) EC. […] It is necessary, therefore, to ascertain whether the legislation in issue enables the Member State concerned *to ensure a minimum level of energy supplies in the event of a genuine and serious threat*, and whether or not it goes beyond what is necessary for that purpose." (emphasis added).

587 See also the recent judgement by the EFTA Court, E-2/06, n. 576, nos 79, 81, 85. The legislation was solely aimed at ensuring a minimum level of energy supply as a public service obligation of the vertically integrated incumbent and securing influence on strategic assets such as supply networks without requiring the need for ownership unbundling. In general, the ECJ has established that the aim to safeguard the supply of products from the areas of oil, telecommunication and electricity, or the rendering of such services in a Member State *in times of crisis* can be a reason of public security, see ECJ, C-463/00, n. 512, no. 71; C-174/04, n. 572, no. 40.

588 But see the Dutch Raad van State in its advice of 17 June 2005 ('Advies inzake het voorstel van wet tot Wijziging van de Elektriciteitswet 1998 en van de Gaswet in verband met nadere regels omtrent een onafhankelijk netbeheer met memorie van toelichting', nr. W10.05.0095/II, 's-Gravenhage, 17 juni 2005) who accepts the supply security exception in this case as sufficient ground for the more general distribution network unbundling legislation in the Netherlands.

589 See ECJ, C-207/07, n. 574, nos 51 *et seq.* See also Ress/Ukrow in Grabitz/Hilf, *Das Recht der Europäischen Union*, Kommentar, Bd. II, Article 58 EGV, no. 37 (n. 7).

590 See n. 580.

or immediately at any given point in time but through the economic goals of promoting competition and establishing an internal market. Thus, if this was permitted as a restriction of Article 56 EC, the ECJ's narrow interpretation of restrictions of fundamental freedoms such as Article 56 EC would be avoided.

For the same reasons, environmental protection through further unbundling legislation can also not be accepted as an overriding restriction of Article 56 EC. The possible claim that greater market transparency would benefit consumer protection can also not be regarded as an overriding restriction of Article 56 EC because greater transparency serves amongst other things also the benefit of consumers but not *per se* or directly consumer protection. Consumer protection[591] is typically concerned with enhancing product security and the fair treatment of consumers in business relationships such as protection from fraud, unexpected terms and conditions and abuse of consumers' inexperience.

To conclude, it can thus be said that prohibiting vertically integrated energy supply undertakings owning and operating energy transmission networks in one Member State from owning and operating energy supply networks in another Member State where ownership unbundling has been introduced, cannot be considered to be a measure that if proportionate would legitimately restrict the free movement of capital according to Article 56 EC. If one does not follow what has just been established, then further unbundling measures must be proportionate, i.e. in order to be justified, they must be suitable for securing the claimed overriding objectives in the general interest and must not go beyond what is necessary in order to attain them. With respect to the proportionality of further unbundling measures, see the elaborations on the proportionality of further unbundling measures in the context of assessing their fundamental rights impact in Part II of this work.[592]

What might already be questioned here is the necessity of further unbundling measures with respect to supply security, and environmental and consumer protection. On the one hand, as investment cannot be imposed as an obligation it is hard to say whether there are any other equally effective measures. On the other hand, there is already extensive legislation in place promoting energy efficiency, favourable treatment of RES and CHP; there is also a Europe-wide Emission Trading Scheme in place.[593] Via the exemption mechanisms in Article

591 For the definition of consumer protection and the measures initiated in this regard by EC legislation, see Wolf in Grabitz/Hilf, *Das Recht der Europäischen Union*, Kommentar, Bd. III, 'A 1. Grundzüge', nos 1–34.

592 See also Part 1 Chapter 2 section II *supra*.

593 See in all these respects already Ehlers, n. 7.

7 of Regulation 1228/2003 and Article 22 of Gas Directive 2003, there are incentives for merchant interconnection, which the market obviously only uses if it is economical to do so, and measures are already in place to secure investment in interconnection such as the obligation to reinvest revenues from congestion charges into electricity interconnectors, see Article 6(6) of Regulation 1228/2003. Further, the Commission itself acknowledges that EU legislation already includes instruments dealing with security of energy supply[594], and more particularly monitoring and reporting tools with respect to energy supply security are in place[595]: Accordingly, Directive 2005/89/EC requires the national regulators, with the help of the transmission system operators, to report yearly to the Commission on security of electricity supply. Directive 2004/67/EC requires Member States to report on the security of the gas supply situation and on the regulatory framework to enhance investment in *infra*structure; the same Directive establishes the Gas Coordination Group and defines a "Community mechanism" in the event of supply disruption, which includes measures in relation to gas stocks. In addition, Gas Directive 2003 introduced general monitoring obligations for the Member States. The proposed amendments to Regulations 1228/2003 (electricity) and 1775/2005 (gas) give the task of making system adequacy forecasts for every summer and winter as well as for the long term to the Network of European Transmission System Operators. All in all, although it is clear that investment into *infra*structure is necessary and that the construction of energy supply *infra*structure requires time, the European Commission does not succeed in showing that there is an imminent threat to supply security.

VI. ARTICLES 5(2) AND (3) EC: (COMPETENCE) SUBSIDIARITY AND PROPORTIONALITY

Under the assumption that article 95 EC confers on the European Union the competence to regulate the European energy networks and, more particular, to introduce further unbundling measures, and leaving aside the substantial concerns raised with respect to the legitimacy of exercising this competence, the exercise of this competence on the basis of Article 95 EC is subject to the observance of the principle of subsidiarity and must be proportionate according to Articles 5(2) and 5(3) EC, respectively.[596]

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594 See already n. 408 and accompanying text.

595 See the *Explanatory Memorandum* accompanying the Commission's proposals of 19 September 2007.

596 Tietje in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. II, Vor Article 94–97 EGV, no. 59, argues with considerable persuasiveness that the principle of subsidiarity according to

With regard to whether harmonization is required at all or the question whether the Community may actually take action (further unbundling measures) because the objectives of the proposed action cannot be sufficiently achieved by the Member States[597] and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community (principle of subsidiarity)[598], further unbundling as a harmonization measure first requires that national provisions are or are sufficiently likely to become an obstacle to the functioning of the common market.[599]

Further, the exercise of the competence to introduce further unbundling must be proportionate, i.e. current legislation must be deficient to such an extent that new legislation requiring more intrusive unbundling measures is appropriate, necessary and proportionate to achieve the objectives outlined in chapter 1 above, or in other words, it must actually be necessary to enforce further unbundling measures in the Member States because current legislation cannot be tightened so as to remedy the shortcomings in individual Member States (by, for instance reducing the leeway for the Member States for interpretation).

The following paragraphs deal with the issue of the subsidiarity and the proportionality of the EU exercising its competence to introduce further unbundling as a single question as these two principles cannot always be clearly distinguished. Germany may serve as an example in many places[600] as it is the

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Article 5(2) EC is not applicable in the context of Articles 94 *et seq.* EC because a measure of approximation of laws can only be enforced by the Community. In this regard, the question of whether such a measure is required (see already n. 504) should actually be answered in the affirmative in order for a competence (here Article 95 EC) to be applicable, see already n. 504. On the other hand, as the ECJ has, for instance in *British American Tobacco* (C-491/01, n. 504), applied the subsidiarity principle (according to Tietje without any added advantage compared to the assessment whether a measure is actually *required*), this position is followed here. As there are strong reasons to believe that the subsidiarity principle is in fact be contravened, following the reasonable view of Tietje would thus indeed lead to the conclusion that a competence according to Article 95 EC does not exist.

597 It is debatable whether it is necessary that *all* Member States cannot fulfill this requirement or whether it must be more than one Member State, see for the first opinion, Streinz in Streinz, EUV/EGV, 2003, Article 5 EGV, nos 38, and for the latter opninion, Calliess in Calliess/ Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 5 EGV, no. 45.

598 See *ibid*.

599 See ECJ, C-376/98, n. 371. Although the Protocol (No 30) on the application of the principles of subsidiarity and proportionality annexed to the Treaty of the European Community (as amended by the Treaty of Amsterdam), OJ 1997 C 340/105, 10.11.1997, last amended by Article 1(9)(g) of Protocol No. 1 to the Treaty of Lisbon of 13 December 2007, OJ 2007 C 306/1, 17.12.2007, provides for guidelines for how to assess this issue, the ECJ does not assess the subsidiarity principle in detail but simply establishes whether the Member States cannot achieve the objectives sought on an EC level with their own national measures. See also ECJ, C-491/01, n. 504, nos 180 *et seq.*

600 For a detailed analysis, see Part 2 Chapter 4 *infra*.

least "developed" EC Member State in terms of energy network unbundling compared to the other two countries at issue here, i.e. energy transmission (and distribution) networks have "only" been legally unbundled (inclusive of the transmission network property transferred to the corresponding transmission system operator).

The Commission claims that not only have the current Directives not been sufficiently implemented into national law but also that further unbundling measures would be necessary to achieve the objectives outlined in chapter 1 above. In April 2006, the Commission sent 28 letters of formal notice commencing infringement proceedings for 17 Member States, followed by the adoption of 26 reasoned opinions addressed to 16 Member States in December 2006.[601] The main thrust of these infringement allegations related to insufficient unbundling not guaranteeing the independence of energy network operators (mostly at distribution network level), the re-introduction of regulated energy prices (preventing entry of new market players)[602] and the failure to grant sufficient powers to the national regulatory agencies (NRAs) as well as the continuance of discriminatory access through existing contractual arrangements (long-term energy supply contracts).[603]

The Commission in particular identified issues relating to lack of clarification on key concepts used in the Gas and Electricity Directives – including for instance the classification of TSOs as opposed to DSOs – of key importance with respect to unbundling requirements. Similar interpretation gaps were identified with respect to the role of the NRAs, in particular the relationship between government and the NRAs, as well as the lack of clarification of how regulators should reconcile national and European regulatory objectives.[604] In addition, there are

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601 In July 2007, the European Commission published its annual report on the application of European Union law in the Member States, which included the application of the 2003 Electricity and Gas Directives, see European Commission, '24th annual report from the Commission on monitoring the application of Community law', COM(2007) 398 final, Brussels, 17.7.2007. This showed that in the majority of Member States, the Directives had not been implemented to the satisfaction of the Commission, see Thomas, n. 25.

602 The Commission had not received any information on public service obligations, especially as regards regulated supply tariffs, see Thomas, n. 25.

603 See Hancher, n. 49, pp. 87 *et seq.*, 97.

604 The Commission claims that in order to improve the effectiveness of energy regulation, regulators must be given the task of promoting the development of the internal market, and not just national markets. This claim, however, does not necessarily entail more regulation in this area in terms of explicitly obliging NRAs to focus more on internal (energy) market related issues because this is already enforceable as a primary EC law obligation deriving from Article 10 EC, which reads "(1) Member States shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the

major gaps in terms of issues which are simply not addressed in the current legislative framework itself, in particular as regards provision dealing with the coordination of regulatory responses to cross-border issues.[605]

On the other hand, it should be recalled that only three years after the implementation deadline for the 2003 Energy Directives on 1 July 2004 and just after the deadline of 1 July 2007 for introducing legal unbundling of the operation of distribution networks, the Commission in September 2007 had already come up with its proposals for the revision of the 2003 Energy Directives, at a time when the current Directives' effectiveness had hardly had the chance to prove its value.

It, however, flows from the rule of law and the general principle of proportionality, more particularly the principles of legal certainty, legal expectations and continuity of legislation[606], that legislation should be given sufficient time to take effect.[607] In this context, it also flows from these principles that a regulatory regime should only be rectified if new objectives are pursued or new facts occur altering the basis for the legislation in place; the objectives underlying the current regulatory framework and the proposed legislation have not changed but new developments have indeed been occurring[608] ever since the sector inquiry was closed and the progress report published[609], both of which are based on figures and facts from 2005, and on which the proposals have been based. This means that the inquiry was mainly concerned with the initial implementation phase of the 2003 Energy Directives, whose full implementation was not due before 1 July 2007. Thus, what matters here and plays a role in the fundamental rights assessment, which follows in Part 2, is the necessity of further unbundling or the question whether there are milder means to achieve the objectives sought, which can only be evaluated after the current regulation has been given sufficient time to take effect.

Germany may serve as a typical example for the claim that insufficient time has passed and that new developments have occurred, which give first indications as to the effectiveness of the 2003 Energy Directives. Since the implementation of

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achievement of the Community's tasks. (2) They shall abstain from any measure which could jeopardize the attainment of the objectives of this Treaty."

605 See n. 603, and n. 492 and accompanying text as regards the growing institutionalization of regulatory cooperation.

606 According to which the legislature should abstain from taking contradictory measures.

607 See only Büdenbender/Rosin, n. 35, and Pielow/Ehlers, n. 35.

608 Which, however, as will be shown *infra* do not justify the revision of the current legislation towards further unbundling.

609 See NN. 3, 10.

these Directives in German law[610] and the establishing of the German regulatory agency *Bundesnetzagentur* (BNetzA) in the summer 2005, considerable progress and noticeable reductions in network tariffs have been achieved.[611] Further, incentive regulation of network charges has been introduced from January 2009[612], which is enforced and supervised by the BNetzA.[613] These are facts, which, it is claimed here, have not been duly taken into account by the Commission.

The Commission further claims that only ownership unbundling prevents the discrimination against third parties requiring network access, and ownership unbundling would be particularly advantageous for the connection of new generation because further unbundling would create special investment incentives for the extension of the electricity networks so that such generation plants could be connected.[614] Referring again to Germany[615], the legislative context has however changed significantly since. On 30 June 2007, the so-called KraftNAV entered into force[616], a regulation, which strengthens considerably the position of new generation. It not only enhances network connection of new generation plants (which cannot be refused for reasons of actual or future capacity restraints) but also gives them priority network access over existing generators. Consequently, this measure promotes investment in new generation.[617]

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610 With the Energy Industry Act (Energiewirtschaftsgesetz – EnWG) of 7 July 2005, n. 171. See in greater Part 2 Chapter 4.

611 See, for instance, the BNetzA's Monitoring Reports (*Monitoringberichte*) 2006, 2007 and 2008, available at www.bundesnetzagentur, and the evaluation report of the German government on the experiences with energy network regulation of 26 September 2007 ("Evaluierungsbericht der Bundesregierung an den Deutschen Bundestag und den Bundesrat nach § 112 EnWG über die Erfahrungen und Ergebnisse mit der Regulierung durch das Energiewirtschaftsgesetz"), BT-Drs. 16/6532.

612 The legislative process of which was already underway when the Commission delivered its September 2007 proposals.

613 Based on ARegV (Verordnung über die Anreizregulierung der Energieversorgungsnetze (Regulation on the incentive regulation of energy supply networks), 26 October 2007, BGBl. I, p. 2529), a regulation based on s. 21a EnWG, see in greater detail Part 2 Chapter 4, and which exceeds the requirements of the 2003 Energy Directives.

614 Contra with respect to the latter issue, Haucap, n. 38, and accompanying text.

615 Further, not only are the network operators obliged to grant non-discriminatory access in Germany, which can be enforced by the regulator, but private network access seekers also have a civil law claim enforceable in the courts, independently from actions of the regulator.

616 Regulation concerning network connection of generation plant (Kraftwerks-Netzanschlussverordnung), n. 344, which is based on s. 17 EnWG.

617 See BNetzA, 'Monitoringbericht 2007', n. 125, p. 61, which confirms that the KraftNAV leads to greater planning reliability for generation investment. According to this regulation, the connection of new generation can only be refused if the point of connection is technically not capable of taking the generated electricity and such capability cannot be achieved by reasonably possible measures undertaken by the network operator such as the upgrading of the point of connection or the reinforcement of the network up to the next network hub. The KraftNAV explicitly stipulates that the network connection cannot be refused by reasoning

Legislative measures of Member States such as this also contribute to ensure reliable and sufficiently sized networks, which network operators are obliged to maintain.[618] Such privileged treatment of new generation as granted by the German KraftNAV is also conducive to ensuring that the network operators fulfil their legal obligation to maintain reliable and sufficiently sized networks and to make the investment necessary.[619]

The Commission claims further that only ownership unbundling would guarantee the necessary incentives for investment into the energy networks, in particular as regards interconnection.[620] In terms of interconnection capacity, it is the aim of the Commission to have 10% of the installed generation capacity available permanently.[621] Germany, for instance, exceeds this requirement by 60%.[622]

With respect to the reasons why the elimination of the capacity restraints on the interconnectors is not progressing as expected, the main reason, again for Germany, is the extensive and time consuming planning and permission requirements. In other Member States obtaining the plant-specific and environmental permissions necessary for the reinforcement of interconnectors on its own takes considerable time under their various different jurisdictions, a

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that the capacity restraints of the network, which is directly or indirectly connected to the point of connection, would or will occur. The KraftNAV thus distinguished between network connection and network access. With respect to network access in case of capacity restraints, the KraftNAV gives privileged network access for a period of a maximum of 10 years to new generation plants. Generators connected to the network between 1 January 2007 and 31 December 2012 will be granted such privileged network access. See in greater detail, T Höppner, 'Die Kraftwerks-Anschlussverordnung – Eine kritische Würdigung', (2008) ZNER 25. See also K-P Schulz, 'Die Liberalisierung der Märkte für die leitungsgebundene Energieversorgung – Bestandsaufnahme und Ausblick', (2008) et 32, 36.

618 See Articles 9, 14 Electricity Directive 2003, Articles 8, 12 Gas Directive 2003. For Germany, for instance, see ss. 12, 14 (for electricity), 15, 16a (for gas) EnWG. See further *infra*, Part 2 Chapter 4 on Germany. This obligation is enforceable by the German energy regulator BNetzA according to Article 65 EnWG.

619 As is the prosecution of discriminatory refusals to connect or grant access by the regulator as well as by private action before the courts.

620 See, for instance, the *Explanatory Memorandum* to the Commission proposal for an Electricity Directive, n. 15, p. 5.

621 See p. 175 of the Commission's 'DG Competition Report on Energy Sector Inquiry', SEC(2006)1724, Brussels, 10 January 2007, which contains the full technical report and includes the Final Report, n. 3, as executive summary.

622 For interconnection investment in Great Britain and the Netherlands, see the corresponding chapters in Part 2 *infra*. The importance of investment in interconnector capacity appears questionable when considering the statement of the German regulatory agency BNetzA, n. 125, that the impact of foreign generation capacity on competition is, at least for Germany which belongs to one of the largest energy supply markets in the European Union, rather small because electricity transport over long distances also entails losses in quantities transported.

fact which is recognized by the Commission.[623] These causes cannot, however, be remedied by further unbundling measures.

Further, it is another claim of the Commission that ownership unbundling would remedy problems of price formation on the electricity wholesale markets. Long-term supply contracts are seen in this context as one of the main reasons for disturbed market mechanisms in price formation and foreclosure of the market.[624] It is not clear, however, how this would change under ownership unbundling, at least for existing contracts. What is more remedying these problems seems to be rather a matter for competition law to resolve.[625]

With respect to the non-discriminatory access to interconnection, it has been shown that ever growing regulatory cooperation and coordination via ERGEG and Regional Initiatives[626], such as the Pentalateral Forum, show tangible results such as the growing implementation of the market based congestion method of market coupling at the national borders.[627] This development aims at the expansion of coordination involving an ever growing number of transmission

623 The Commission itself has established that network and more particularly interconnector investment is often subject to time and resource consuming planning and permission procedures or meets the resistance of the local population, see Communication of the Commission, 'Priority Interconnection Plan', COM(2006) 846 final, Brussels, 10.1.2007, pp. 8 *et seq*. The German regulator BNetzA, however, also acknowledges that energy network and interconnector investment is increasing substantially, see Kurth, n. 345, who further confirms that interconnection investment at the German borders is catching up.

624 See Final Report of sector inquiry, n. 3, pp. 6, 8, 11.

625 In this regard, see already chapters 1 and 2 *supra*.

626 In this context, it is worthwhile to remember that the ERGEG+ model outlined *supra* (and even more ACER, which is now in the process of being established, see also *supra*) will lead to the adoption of binding decisions on individual NRAs and will also develop binding measures for the implementation of new technical rules instead of mere guidelines, which is conducive to the ever growing regulatory coordination directed at the technical aspects of grid coordination as well as harmonization of measures relating to the provision of ancillary services, such as balancing and flexibility services, storage and the like. See further Hancher, n. 49, p. 106.

627 See nn. 474 *et seq*. and accompanying text. Regional cooperation and coordination is also a means supportive of greater independence of regulatory agencies. As regards capacity hoarding, the current Directives require mechanisms to remedy capacity restraints, see Article 23(1)(b) Electricity Directive 2003 and Article 25(1)(b) Gas Directive 2003. In Germany, s. 13 NZV Gas (Verordnung über den Zugang zu Gasversorgungsnetzen (Regulation concerning the access to gas supply networks), 25 July 2005, BGBl. I, p. 2210), see further *infra*, Part 2 Chapter 4 on Germany, provides for the duty to release unused capacity (so-called use-it-or-lose-it obligation, see n. 199) and powers to revoke booked but unused capacity. Thus, non-discriminatory access can be achieved by regulation. The regulatory agency BNetzA possesses strong competences in this regard, see Article 65 EnWG.

system operators (within certain market regions) and is a further significant step towards greater transparency in the market.[628]

Further, as has already been indicated in chapter 2 above, ownership unbundling would still require additional regulation to ensure transparency, ease of switching energy suppliers and investment. Only if the market structures were balanced, would further unbundling possibly make sense and guarantee effective competition in energy supply. In non-balanced market structures, market asymmetries would not be reduced by ownership unbundling, at least not initially, nor even significantly remedied.[629]

The preceding elaborations have put the Commission's reasoning, in particular on the basis of its sector inquiry, into perspective.[630] Many objectives of the current regulatory framework can be achieved at Member States' level if only regulation was given sufficient time to show its effectiveness.[631] As has already been said above, sufficient time before reviewing current legislation and rendering very extensive amendments to current legislation only after such legislation has had the chance to prove itself belongs to the fundamental principles of the rule of law.

For such areas, which might not be considered adequately covered by current regulation, tightening legislation would seem to be a proportionate way forward to achieve the objectives outlined in Part 1 Chapter 1, no matter which unbundling regime is in place. Likely candidates are, for instance, the areas of network investment and wholesale market transparency[632], as would be the passing of supportive legislation for intensifying regional cooperation and coordination of NRAs and TSOs[633], a mode of governance which has proved its effectiveness.

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628 As regards the possible introduction of further measures to enhance market transparency and non-discriminatory access to information, see Büdenbender/Rosin, n. 35, pp. 28–9.

629 This also seems to be the view of the German regulator BNetzA, see Schulz, n. 617, p. 38.

630 See in particular nos 51 *et seq.* of the Final Report, n. 3.

631 Experiences such as in the Netherlands suggest, for instance, that with adequate regulation, it is possible within the current European regulatory framework to effectively uncover and even stop cross-subsidization of vertically integrated energy supply undertakings and in particular between the network operations and the supply businesses, see n. 156, which is one of the declared goals of EC energy sector regulation, see chapter 1 *supra* and Article 19(3), (4) and Article 23(1)(e) Electricity Directive 2003, Article 17(3), (4) and Article 25(1)(e) Gas Directive 2003.

632 As regards the first, for instance the amendment of Regulation 1228/2003, n. 219, might be considered to be prescribing the reinvestment of profits from interconnector congestion charges into interconnectors only. As regards the latter, see n. 628.

633 In this regard see the draft Energy Directives, n. 33, 372. Whereas further unbundling measures would require implementation first followed by a lengthy process of restructuring of the European energy industry, the establishment of regional markets and institutions is

Against the background of rapid progress of regulation by cooperation and coordination and its institutionalization and the proliferation of regional market coupling in the framework of existing comprehensive sector-specific regulation[634], the exercise of the competence to introduce further unbundling measures such as ownership unbundling or "deep" ISOs appears to be in breach of the principles of subsidiarity and (competence) proportionality.

These conclusions also receive some support from economists. The social cost and benefit analysis of *Brunekreeft* discussed in chapter 2 above indicates that further unbundling measures would not be proportionate to the rather marginal gain achieved. Rather, sufficient generation capacity matters[635], which is something falling into the sole remit of the Member States.

VII. CONCLUSIONS

This chapter analyses further unbundling measures in the context of sector-specific regulation, more specifically with respect to the question whether further unbundling can actually be enforced on the basis of Article 95 EC.

As a result of what has been established in chapter 2, in particular in the context of the proportionality of a potential competition law based structural remedy of divestiture of energy supply networks, the provision of sufficient generation capacity in the course of safeguarding electricity supply security appears to render the legislative separation of energy transmission networks less effective compared to TPA imposed by sector-specific regulation combined with competition law enforcement in individual cases. Gas transmission network ownership unbundling even seems to conflict with the objective to safeguard gas supply security.

It has further been established that the European energy supply industry is already comprehensively regulated albeit with deficiencies in the area of cross-border competencies of NRAs. In this context, it is a fact that the comprehensive regulation in place on a European level lacks coherent implementation in the

already underway and can be regarded as a significant intermediate step towards a truly internal market for energy supply, which it is one of the predominant objectives of the European Commission to achieve.

634 Although with gaps in the area of cross-border competencies of NRAs, which regulation by cooperation and coordination is supposed overcome.

635 This can also be inferred from the 2007 sector monitoring report of the German regulatory agency BNetzA, n. 125, p. 61.

Member States due to too great a leeway for interpretation granted by such regulation.

An in-depth analysis of Article 295 EC shows that for reasons of constitutional law the European Union must not exercise its competence to introduce further unbundling measures, at least not when it comes to complete ownership unbundling. With respect to the imposition of independent system operators, it has also been substantiated that only such models should be allowed to be introduced, which do not confer investment decision powers on the independent system operator alone thereby stripping the network owners off any means to exercise influence.

Unlike Article 175 EC, which is concerned with environmental policy, the future Article 194 TFEU to be introduced once the Lisbon Treaty has entered into force specifies vertical integration as being in the sole remit of the Member States when measures in the area of *energy policy* are undertaken.

The introduction of further unbundling would also be in breach of Article 56 EC, the fundamental freedom of the free movement of capital. It would not fall within the rules which may allow a restriction (if proportionate) of this freedom by reasons referred to in Article 58(1) EC or to fulfil an overriding requirement of the general interest.

Further, as has just been explained in the previous section, the principle of subsidiarity would not be sufficiently observed if further unbundling was introduced at this point in time; the proportionality of exercising the competence for further unbundling measures is also questionable.

What is required though is a more stringent implementation of the current regulatory framework and amendments to it so as to, for instance, cut down on the interpretation leeway left to the Member States[636] and safeguard sufficient investment in energy network interconnection. It has been shown that albeit only in force for a short while, legal and operational unbundling has proved in many respects that it can live up to the expectations placed upon it by current legislation if only properly implemented.[637] The developments in regulatory coordination

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636 With respect to unbundling, ERGEG notes that mainly functional unbundling (involvement of the management of the network business in vertically integrated competitive activities and *vice versa*) was not sufficiently effective because the relevant unbundling provisions of Article 15 Electricity Directive 2003 and Article 13 Gas Directive 2003 were not sufficiently clear. See ERGEG, n. 479.

637 As has been confirmed by the German regulator BNetzA in its 2008 Monitoringbericht, n. 329, p. 224, which reports a complaint received about an abuse, which a vertically integrated

and TSO and NRA cooperation have further shown that non-discriminatory and transparent interconnection (congestion) management can be achieved and supported by the unbundling regime in place without further unbundling being necessary.

generation undertaking raised against its transportation network sister undertaking. This shows that the independence of vertically integrated network undertakings can indeed be achieved on the basis of the current provisions.

PART 2
FUNDAMENTAL RIGHTS

In Part 1, the rationale behind the economic regulation of EC energy supply networks has been outlined in chapter 1, followed by an analysis of the first leg of economic regulation in chapter 2, namely the EC competition law enforcement in the area of the operation of vertically integrated energy network operation with particular focus on the possibility of ordering divestiture of energy supply networks in individual cases; the core issue here was the assessment of the economic proportionality of such a measure, which is similarly applicable in Part 2 below. Part 1 Chapter 3 has dealt with the question of the competence for the second leg of economic regulation of EC energy supply networks, i.e. sector-specific regulation with an emphasis placed on unbundling of such *infra*structures. Part 2 of this work now focuses on the fundamental rights issues, which need to be considered when introducing further unbundling measures in the way the Commission planned to do it in September 2007. Chapters 4–6 concentrate on the Member States chosen for this analysis, i.e. Germany, the United Kingdom (more particularly Great Britain) and the Netherlands, followed by fundamental rights issues arising on EU level.

CHAPTER 4
GERMANY

I. INTRODUCTION

This chapter deals with the constitutional issues arising in Germany should more intrusive forms of unbundling be introduced. More specifically, the proposals of the European Commission as outlined in the Introduction will be scrutinized as regards their compatibility with German constitutional law.

Section II outlines the evolution and current structure of network-bound energy supply in Germany and the role German municipalities have been playing all throughout this development. Here, the current regulatory and competition law environment which the German energy supply industry is facing, is outlined. Further, following on from the explanations of different forms of unbundling in the Introduction, these are discussed in more detail in this section because compared to the other two EC Member States at issue here, energy transmission in Germany is "only" legally unbundled whereas the networks in Great Britain and the Netherlands are further unbundled. These additional details are also important in order to better understand the brief discussion of Effective and Efficient Unbundling (the so-called "Third Way", see Introduction) towards the end of this chapter.

Section III illustrates the constitutional setting relevant to this work, in particular the residual state responsibility for energy supply, the constitutional background of German municipalities and the role of the BVerfG.

Also included here is a brief discussion of the relationship between EC and national law according to German constitutional law and its interpretation by the BVerfG with a focus on the *Solange*[638] doctrine and its ruling in re *Maastricht*.[639] In particular, the circumstances, under which German constitutional law is

638 BVerfGE 37, 271 *et seq.* and BVerfGE 73, 339 *et seq.*, concerning the level of human rights protection in the EU.

639 BVerfGE 89, 155 *et seq.*, concerning matters of *Kompetenz-Kompetenz* (competence to define competences), and, more generally, the *Kooperationsvorbehalt* (reservation of cooperation) of the BVerfG.

applicable to German legislation implementing EC Directives will be set out here.

Other issues include the position of the ECHR in German law and the judicial review of the German legislature's margin of appreciation and the proportionality test in Germany.

Section IV deals with the fundamental rights issues arising in the context of further unbundling legislation. Although in the context given, the right to property as set out in Article 14 GG is by far the most important fundamental right, other fundamental rights of the German Grundgesetz relevant here will also be discussed briefly. Of particular importance here will be the question of whether public and public-private energy supply undertakings (wholly of partly owned by public law bodies such as municipalities)[640] should be eligible for fundamental rights protection, in particular when subjected to legislation imposing further energy supply network unbundling.

Section V will then apply the framework set in section IV to further unbundling measures. Slightly deviating from the analysis in other parts of this work, in particular as regards the proportionality of further unbundling legislation, section V will explore under which circumstances the introduction of an Independent System Operator (ISO) model would be in compliance with German constitutional law.

Section VI will briefly refer to Article 56 EC, which would become applicable in the unlikely case that Germany introduced stricter unbundling rules unilaterally.

Section VII summarizes the findings of this chapter and concludes.

II. NETWORK-BOUND ENERGY SUPPLY

1. EVOLUTION AND STRUCTURE

Network-bound energy (electricity and gas) supply was initially provided by private rather than state undertakings.[641] With the development of street lighting

640 For a definition in the context of the European Union, see Part 2 Chapter 7 on the European Union.

641 For a detailed treatise on the history of the German energy industry, see G Hermes, *Staatliche Infrastrukturverantwortung*, 1998, § 13, and J-C Pielow, *Grundstrukturen öffentlicher*

and tram systems, larger cities in particular became increasingly involved in the energy sector through their own city works (*kommunale Versorgungsunternehmen*, often also called "Stadtwerke"). In rural areas, however, municipalities continued to depend on co-operation with private undertakings because of the considerable financial resources required to establish a suitable supply system. Thus, not only municipalities but also private and private-public partnerships performed the task of supplying energy.[642] Whilst large *supra*-regional energy supply undertakings evolved, the former *Deutsches Reich* and the German *Länder* also began to enter the energy market. As a consequence of the increasingly commercial operation of large power plants, a concentration and monopolization process took place, which led to the enactment of sector-specific legislation in 1935[643], leaving, however, the existing industry structure intact.

The German electricity supply sector traditionally consists of three levels.[644] The first level accommodates so-called *Verbundunternehmen*, which develop, maintain, and (inter-) connect the *supra*-regional high-tension grids and operate the central power plants.[645] There are four such compound utilities, which are vertically integrated.[646] The second level comprises local utilities and end consumers (in terms of gas supplied for electricity generation purposes) predominantly in rural areas (*Regionalversorger*). The third level consists of more

Versorgung, 2001, pp. 573 *et seq.* As regards a detailed account of energy supply in Germany and its regulation, see J-C Pielow, H-M Koopmann, E Ehlers, 'Energy Law in Germany', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, chapter 9.

642 An early example for private-public partnerships in the energy sector is the incorporation of *Rheinisch-Westfälische Elektrizitätswerke AG* (RWE) by the city of Essen and several private undertakings such as the industrialist Hugo Stinnes in 1898.

643 Gesetz zur Förderung der Energiewirtschaft (Act for the Promotion of the Energy Industry – EnWG 1935) of 13 December 1935, RGBl I, p. 1451.

644 See also s. 3 no. 18 EnWG.

645 Such companies operate so-called *Verbundnetze*, which are a number of electricity transmission and distribution networks connected with each other by one or several connection cables, or a number of interconnected gas supply networks.

646 As a result of the ongoing energy market liberalization, the German energy sector has become increasingly concentrated throughout the whole energy supply chain resulting in four energy utility groups: E.ON AG, EnBW AG, RWE AG and Vattenfall Europe AG, each with separate subsidiaries for electricity generation (e.g. *RWE Power AG*), network operation (e.g. *RWE Energy AG*) and trade (e.g. *RWE Trading GmbH*), in accordance with the unbundling requirements of the EnWG. For a detailed account of the shareholder structure of these undertakings and their wide-spread (cross-)shareholdings throughout the German energy sector, see Monopolkommission, 'Strom und Gas 2007: Wettbewerbsdefizite und zögerliche Regulierung', Sondergutachten 49, 2007, Anhang (Annex). See also, from an economist's point of view, G Brunekreeft, D Bauknecht, 'Distributed Generation and the Regulation of Electricity Networks', in F Sioshansi (ed.), *Competitive Electricity Markets: Design, Implementation, Performance*, 2008, chapter 13.

than 850 local utilities[647], which are primarily concerned with supplying electricity within their respective municipalities. Additionally, independent electricity generation is growing, in particular distributed generation (DG) from renewable energy resources (RES).[648]

The organization of network-bound gas supply basically follows the same tripartite patterns as the electricity sector with *Verbundunternehmen* (some of which also import gas)[649], regional utilities and local suppliers (more than 720).[650]

At present, at transmission network (*Verbundunternehmen*) level, only the shareholdings in the listed public limited company E.On AG (approx. equivalent of an English plc) are predominantly private with a wide shareholder basis whereas the State and municipalities own significant shareholdings in the other transmission network companies:

Vattenfall Europea AG is entirely owned by Vattenfall AB, which itself is completely owned by the Swedish State.[651] Municipal shareholders of RWE, on the other hand, hold approx. 27% of its shares, which confers upon them a blocking minority. The communal/municipal grouping of "Oberschwäbische Elektrizitätswerke" and EDF, the French state owned vertically integrated electricity company, both hold an equal proportion of shares (45,01%) in EnBW.[652]

2. REGULATION

The above mentioned sector-specific legislation remained substantially unchanged until the liberalization of the German energy sector in 1998.[653] In

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647 For exact figures, consult the lists of electricity and gas network operators, which are periodically updated by the *Bundesnetzagentur* (BNetzA) and available on its website www.bundesnetzagentur.de.

648 For a defition of distributed generation, see n. 8. See also Brunekreeft/Ehlers, n. 38.

649 In particular E.ON Ruhrgas AG; other gas importers are Thyssengas GmbH, Verbundnetz Gas AG and Wintershall Gas GmbH (WINGAS).

650 See n. 647. See also Monopolkommission, n. 646. Many of the network operators operate both electricity and gas networks.

651 As they (i.e. EDF also, see *infra*) are controlled by foreign public entities, which naturally do not have any sovereign powers in Germany, they are not regarded as German public shareholders, which are bound to obey fundamental rights as German public entities are, see *infra*.

652 For more details, see Monopolkommission, n. 646, no. 611 and Anhang (Annex).

653 With the Gesetz über die Elektrizitäts- und Gasversorgung (Energiewirtschaftsgesetz (Energy Industry Act) – EnWG 1998) of 24 April 1998, BGBl I, p. 730. For details of the 1998 amendments

this context, however, the enactment of the Law against competition restraints in 1957 deserves mention.[654] In order to preserve the traditional 'area monopolies' (*Gebietsmonopole*), monopoly contracts between the energy supply companies (*Demarkationsverträge*), as well as contracts between such companies and the municipalities stipulating access rights to the public (municipal) highways (*Konzessionsverträge*), were exempted from the application of competition law until 1998.[655]

On 13 July 2005, the new Energy Industry Act (EnWG) entered into force[656], implementing the 2003 Electricity and Gas Directives and completely revising the energy industry legislation existing at the time in Germany.[657] The main challenges for the German legislator were the transformation from negotiated to regulated network access[658] as well as the implementation of the stricter unbundling requirements, in particular legal and operational unbundling. As regards the degree of energy market opening, the German energy market already formally complied with the requirements of the 1996 and 1998 Electricity and Gas Directives, since 1998 and 2003, respectively.

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and the old law more generally, see J-C Pielow, H-M Koopmann, 'Energy Law in Germany', in M Roggenkamp, A Rønne *et al.* (eds), *Energy Law in Europe*, OUP, 2001, chapter 8, nos 8.101 *et seq.*

654 Gesetz gegen Wettbewerbsbeschränkungen (Law against competition restraints) of 27 July 1957, BGBl I, p. 1081.

655 See n. 139.

656 N. 171. For an introduction to the new legal environment in Germany, see E Ehlers, 'The New German Energy Industry Act: Do Good Things Come to Those Who Wait?', (2004/2005) 6 Utilities Law Review 263; G Kühne, C Brodowski, 'Das neue Energiewirtschaftsrecht nach der Reform 2005', (2005) NVwZ 849; C Koenig, J Kühling, W Rasbach, *Energierecht*, 2006, pp. 35 *et seq.* See also S Klauer, 'The new German energy regulator – context and structure', in M Roggenkamp, U Hammer (eds), *European Energy Law Report II*, 2005, chapter 6, p. 83; K Pritzsche, S Klauer, 'Germany', in P Cameron, (ed.), *Legal Aspects of EU Energy Regulation*, OUP, 2005, chapter 8, p. 145. G Brunekreeft, D Bauknecht, 'Energy Policy and Investment in the German Power Market', in F Sioshansi, W Pfaffenberger (eds), *International experience in restructured electricity markets: What works, what does not and why?*, 2006, chapter 8, provide an in-depth analysis of the new EnWG from an economist's point of view and a very instructive overview of the structure of the German energy sector.

657 On the old law, see Pielow/Koopmann, n. 653.

658 In 2003, the Federal Ministry for Economic Affairs and Employment already recognized that this transformation was necessary, see 'Bericht über die energiewirtschaftlichen und wettbewerblichen Wirkungen der Verbändevereinbarungen (Monitoring Bericht)' of 31 August 2003. For the same point, see also the German Monopolkommission in its 14th Hauptgutachten (main report) 2000/2001 on 'Netzwettbewerb durch Regulierung'. For a very instructive comment on the so-called self-regulatory industry association agreements (*Verbändevereinbarungen*), which played an important role under the old regulatory environment in Germany, see Klauer, n. 656, p. 85. See also Brunekreeft and Bauknecht, n. 656, who point out that refraining from regulating network access *ex ante* was unsatisfactory, and that from an economist's point of view, network regulation should be 'expected to promote competition and thereby stimulate new investment by newcomers'.

The new EnWG did not pass parliament until more than a year after the original implementation date of 1 July 2004. The delay was mainly due to intensive political discussions. Until the very end, the following issues were subject of vigorous discussion: the content and degree of *ex ante* access regulation, the peculiarities of access to the gas networks and the allocation of regulatory competences between the federal government and the *Länder*.

The new law contains a broad range of authorizations for the federal government to enact statutory instruments (*Rechtsverordnungen* or Regulations), which are, inter alia, concerned with network access and access charges[659], general rules for distribution network connection and rules for universal supply and supply of last resort[660], and lately also the Regulation providing for the introduction of incentive regulation from the beginning of 2009 (ARegV)[661], and a Regulation promoting network connection and access of generation capacity (KraftNAV)[662], which has already been dealt with in Part 1 Chapter 2.

The German legislator has enacted a system of *ex ante* regulation of network charges, followed by incentive-based regulation as of 1 January 2009. Furthermore, issues of network access and charges are dealt with by regulatory authorities which have been operational since July 2005. These are the Federal Networks Agency for Electricity, Gas, Telecommunications and Railways (Bundesnetzagentur – BNetzA)[663] and the regulatory agencies of the German *Länder*. Only networks crossing the territory of more than one German state,

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659 Verordnung über den Zugang zu Elektrizitätsversorgungsnetzen (Regulation concerning the access to electricity supply networks – NZV Strom), 25 July 2005, BGBl. I, p. 2243; NZV Gas, n. 627; Verordnung über die Entgelte für den Zugang zu Elektrizitätsversorgungsnetzen (Regulation concerning the charges for access to electricity supply networks – NEV Strom), 25 July 2005, BGBl. I, p. 2225; Verordnung über die Entgelte für den Zugang zu Gasversorgungsnetzen (Regulation concerning the charges for access to gas supply networks – NEV Gas), 25 July 2005, BGBl. I, p. 2197.

660 Verordnungen zum Erlaß von Regelungen des Netzanschlusses von Letztverbrauchern in Niederspannung und Niederdruck (Regulations regarding the enactment of rules for the connection of end consumers to low voltage electricity and low pressure gas networks), 1 November 2006, BGBl. I, p. 2477; Verordnung zum Erlaß von Regelungen für die Grundversorgung von Haushaltskunden und die Ersatzversorgung im Energiebereich (Regulation regarding the enactment of rules concerning universal supply of household customers and concerning supply of last resort in the energy sector), 1 November 2006, BGBl. I, p. 2391.

661 N. 613.

662 NN. 344, 615 (and accompanying text).

663 Previously Regulierungsbehörde für Telekommunikation und Post (RegTP). As regards the controversy from a constitutional point of view over the institutional setting in particular whether the BNetzA should become a part of the Federal Competition Authority (Bundeskartellamt), a self standing federal authority or a private law regulatory body, see P Tettinger, J-C Pielow, 'Zum neuen Regulator für den Netzzugang in der Energiewirtschaft aus Sicht des öffentlichen Rechts', (2003) Recht der Energiewirtschaft (RdE) 289, and F Säcker,

and which belong to vertically integrated energy undertakings with more than 100,000 connected customers, are regulated by the BNetzA.[664]

The Act emphasizes that network-bound energy supply must be secure, inexpensive, environmentally and consumer friendly, and efficient.[665] In addition, energy industry regulation aims to promote genuine competition and to safeguard the long-term reliable operation of energy supply networks. This puts the regulatory agencies under considerable pressure, as they have to prioritize potentially conflicting goals: regulation and efficiency gains are not absolute but have to be put in perspective by quality considerations when it comes to network stability.

As regards control of market entry, only first time energy supply network operations require authorization. A new energy supply to household customers must merely be notified in order to give the competent regulatory authority the opportunity to prohibit or restrict such activity.[666] The supply of additional customers and end consumers does not require any permissions or notifications.

For electricity networks of 110 kV or higher and gas supply pipelines of 300 millimetre diameter or more, the EnWG requires the official approval of the corresponding project plan resulting from a public law planning procedure (*Planfeststellung*).[667] Such a *Planfeststellungsverfahren* is only necessary if an environmental impact assessment has to take place; otherwise, a simplified public law procedure leading to the approval of a plan (*Plangenehmigungverfahren*) suffices.[668] Under certain conditions, property can be expropriated for network construction purposes.[669]

'Ex-Ante-Methodenregulierung und Ex-Post-Beschwerderecht', (2003) Recht der Energiewirtschaft (RdE) 300.

664 S. 54(2) EnWG.

665 S. 1 EnWG.

666 SS. 4 and 5 EnWG. The authorization of electricity generation and gas storage facilities as well as LNG terminals is not covered by the EnWG. Such authorizations are dealt with by the Bundes-Immissionschutzgesetz (Federal Immission Protection Act – BImSchG) of 15 March 1974, revised version (*Neufassung*) published on 15 July 1985, BGBl. I, p. 3830, as amended, or by the Atomgesetz (Atomic Energy Act – AtG) of 23 December 1959, revised version (*Neufassung*) published on 26 September 2002, BGBl. I, p. 1565, as amended.

667 A plan approval is the conclusion of a formal administrative procedure. It is binding on public institutions and, at the same time, replaces various other administrative decisions and acts, such as permissions and licences. Without such a procedure, many larger projects, such as railway, electricity, gas and other networks, would have to undergo a number of administrative procedures, such that efficient and consistent planning would become extremely time-consuming and almost impossible.

668 See for further details, ss. 43 *et seq.* EnWG.

669 SS. 45 and 45a EnWG.

Unbundling

Unbundling of the energy sector is certainly among the most predominant and progressive features of recent German energy supply legislation.[670]

All unbundling measures apply to vertically integrated energy supply undertakings[671], which transmit gas through high-pressure pipeline networks or electricity through high-voltage or extra-high-voltage grids, and at the same time either supply energy in terms of retail to (end) customers and/or generate/produce electricity/gas.[672]

Distribution network operators, which are part of vertically integrated energy supply undertakings, were given until 1 July 2007 to implement legal unbundling.[673] A *de minimis* clause has been applied to smaller distribution network operators, which means that operators with less than 100,000 connected customers are permanently exempted from legal and operational unbundling.[674] Generally, the operators of gas storage facilities and liquefied natural gas (LNG) facilities do not have to comply with the legal and operational unbundling requirements.[675] However, no matter whether operators are transmission, distribution, storage or LNG operators and whether they are vertically integrated

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670 See in greater detail B Malmendier, J Schendel, 'Unbundling Germany's Energy Networks', (2006) JENRL 362; N Tödtmann, U Setz, 'Umsetzung der Entflechtung im deutschen Energiewirtschaftsrecht (Überblick)', in J Baur, K Pritzsche, S Simon (eds), *Unbundling in der Energiewirtschaft*, 2006, chapter 3. As regards company law related problems occurring as result of the current implementation of unbundling in Germany, see T Volz, *Das Unbundling in der britischen und deutschen Energiewirtschaft*, 2006, pp. 166 *et seq.*

671 SS. 3(38) EnWG implementing Articles 2(21) and 2(20) Electricity and Gas Directives 2003 respectively, in conjunction with Article 3(1) and (2) Merger Regulation. See also the Commission's Unbundling Note, n. 448 and accompanying text.

672 SS. 3(19) and (32), 6–10 EnWG implementing Articles 2(3), 10, 17 Electricity Directive 2003, Articles 2(3), 9 and 15 Gas Directive 2003. Upstream gas pipelines, i.e. pipelines from gas production sites to terminals connecting these sites to the gas transmission network do not fall under these rules, see ss. 3(16), (19), (20) and (39) EnWG based on Article 2(2), (3) Gas Directive 2003.

673 S. 7(3) EnWG based on Articles 15 and 30(2) Electricity Directive 2003, Articles 13 and 33(2) Gas Directive 2003.

674 SS. 7(2), 8(6) EnWG implementing Articles 15(2) and 13(2) Electricity and Gas Directives 2003, respectively. The 2003 Energy Directives use the term 'functional' unbundling. For further details on the term 'connected customers' and the repercussions the group structure, in which the distribution network operator is embedded, has in this respect, see Tödtmann/Setz, n. 670, p. 68.

675 S. 6(1) last sentence EnWG clarifying Articles 7(1) and 9 Gas Directives 2003.

or not, they all have to comply with the prescribed accounts and informational unbundling provisions.[676]

The network owner is responsible for appointing the network operator(s) carrying out the transmission or distribution of energy and maintaining and developing/extending the network(s) they operate.[677] As the network operator manages the network, it must have unlimited control of all aspects of network operation. More specifically, since the network operator is entitled to use the network on its own account, it must also bear the operational costs and responsibilities.[678]

The German legislator largely reproduced the relevant and rather broadly drafted sections of the 2003 Energy Directives[679] when formulating the German unbundling requirements. There are, thus, hardly any clear operational directions to be found on unbundling in the EnWG, which leaves it to the courts, the BNetzA and state regulators to provide a precise interpretation.[680]

As has already been explained, legal unbundling is the separation into legally separate companies of energy production and supply on the one hand, and the operation of electricity and/or gas transmission and/or distribution on the other.[681] The network operating company and the network as such, in one company or separate, may both be owned by an energy supply company but not vice versa: a network operator is not allowed to pursue energy production and supply within the same company nor to have an interest such as shares in an

676 SS. 9 and 10 EnWG implementing Articles 12, 16 and 19 Electricity Directive 2003, Articles 10, 14 and 17 Gas Directive 2003.

677 SS. 3(5)-(7) and (10), 11–16a EnWG implementing Articles 8, 9, 13, 14 Electricity Directives 2003, Articles 7, 8, 11, 12 Gas Directive 2003.

678 See in this respect also C Koenig, A Haratsch, W Rasbach, '*Neues aus Brüssel zum Unbundling: "Interpreting Note" zu den Beschleunigungsrichtlinien für Strom und Gas*', (2004) ZNER 10, 13; Säcker and Boesche in Säcker, *Berliner Kommentar zum Energierecht*, 2004, § 6 EnWG, p. 829, no. 44.

679 The (non-binding) Commission's Unbundling Note referred to in n. 448 can assist in the interpretation of the Directives' unbundling provisions. With regard to the scope of the Directives' unbundling provisions from a German law point of view, see Koenig/Haratsch/Rasbach, n. 678, p. 11.

680 The *Gemeinsame Auslegungsgrundsätze der Regulierungsbehörden des Bundes und der Länder zu den Entflechtungsbestimmungen in §§ 6–10 EnWG* of 01.03.2006 (Joint interpretative guidelines of the federal and state regulatory agencies on the unbundling provisions in ss 6–10 EnWG) of 01.03.2006 ("Joint Guidelines") serve as interpretative guidelines, which are not legally binding.

681 SS. 6(1) and 7(1) EnWG based on Articles 10(1), 15(1), 17 Electricity Directive 2003, Articles 9(1), 13(1), 15 Gas Directive 2003. As regards the tax privileges afforded to transactions in the context of legal and operational unbundling, see ss. 6(2), (3) and (4) EnWG. See also Tödtmann/Setz, n. 670, p. 72, no. 73; Pritzsche/Klauer, n. 656, p. 149, no. 8.16.

energy production or supply company.[682] Under German law, ownership of the network assets can be but does not have to be transferred.[683]

That legal unbundling only concerns the separation of energy network operation from energy production and supply is particularly relevant to the German energy supply industry. This is because commercial interests in other areas do not constitute a vertically but a horizontally integrated undertaking.[684] Thus, network operators are allowed to supply commodities or operate networks, which are not related to energy, such as water. This is of particular importance to municipalities, which often operate several supply services, such as energy distribution and supply, water distribution and other supply, waste disposal and (local) public transport, and activities requiring continuous financial support, such as municipal swimming pools, museums and theatres, in combination (so-called *Querverbund*).[685] As long as the operation of the energy networks remains independent, a conflict with the unbundling provisions does not arise. What is

682 See Unbundling Note, n. 448, pp. 4, 8, 9. The reason is that the management of the network operator would retain an incentive for discriminating in favour of its subsidiary. The operational unbundling provisions (see in more detail *infra*), however, hinder the management of the network operator from directly or indirectly participating in the day-to-day operations of energy production or supply, s. 8(2) 1st sentence EnWG based on Articles 10(2)(a), 15(2)(a), 17(a) Electricity Directive 2003, Articles 9(2)(a), 13(2)(a), 15(a) Gas Directive 2003. Further, the management of the network operator has to be in a position to act independently of other business interests, s. 8(3) EnWG based on Articles 10(2)(b), 15(2)(b), 17(b) Electricity Directive 2003, Articles 9(2)(b), 13(2)(b), 15(b) Gas Directive 2003. See also F Säcker, n. 30, and 'Das neue "institutionelle Design" des Independent System Operator', (2007) 11 et 86, and *Der Independent System Operator – Ein neues institutionelles Design für Netzbetreiber?*, 2007, setting out the (mainly company law related) amendments, which would have to be made to German law, exceeding the requirements of the 2003 Energy Directives, in order to optimize the independence of system operation in Germany within the current legislative framework.

683 This is reflected in the legislative motives (see 'Gesetzentwurf der Bundesregierung, Entwurf eines Zweiten Gesetzes zur Neuregelung des Energiewirtschaftsrechts' of 14 October 2004, BT-Drs. 15/3917, p. 51, right column), which serve as an important interpretative tool for the EnWG and state that 'the unbundling of ownership, i.e. the sale of the network operations division, and also the transfer of ownership of network assets is not mandated.' Thus, shares in a network operator do not also have to be disposed of. Recitals 8 and 10 Electricity and Gas Directives 2003, respectively, confirm that legal separation does not imply a change of ownership of assets. According to Articles 10(1) last sentence, 15(1) last sentence, 17(1) last sentence Electricity Directive 2003, Articles 9(1) last sentence, 13(1) last sentence, 15(1) last sentence Gas Directive 2003, nothing in the 2003 Energy Directives shall create an obligation to separate the ownership of assets of the network operator from the vertically integrated undertaking which, for the four electricity transmission system operators vertically integrated into E.ON, RWE, EnBW and Vattenfall has, however, happened.

684 See Article 2(23) Electricity Directive 2003, Article 2(21) Gas Directive 2003.

685 For the German concept of *Daseinsvorsorge* and its EC law equivalent of services of general (economic) interest, see nn. 760, 780 and accompanying text. As to the questions of state aid, see n. 785.

not allowed, however, is the combination within one legal entity of, say, electricity networks operation and gas supply.[686]

As has already been explained, legal unbundling is merely the formal requirement to operate the network separately from the remaining vertically integrated energy supply undertaking. Operational (or management or functional) unbundling, supplements legal unbundling. As the main intention of operational unbundling is to safeguard the independence of the network operator from other units of the vertically integrated undertaking[687], the network operator must be equipped with sufficient human, physical and financial resources and means to operate the network independently.[688] Management decisions with regard to the operation of the energy networks must not be influenced by the holding company.[689] Operational unbundling, however, is not supposed to interfere with the network operator shareholders' reasonable economic interest[690], i.e. the network operator's competences should not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets in a subsidiary are protected.[691] Consequently, shareholders are left with a number of strategic and business related decisions as long as these do not deprive the network operator of its assets, its control over the networks or the necessary financial means.[692] Typical ownership related decisions such as the disposal of shares, the payment of dividends and other profit related decisions are thus still the shareholders' remit. Shareholders may also set global limits on the level of indebtedness or approve an annual financial plan as well as individual construction projects exceeding the

686 See BT-Drs. 15/3917, n. 683, p. 51; Unbundling Note, n. 448, pp. 6, 10. However, the joint operation of gas and electricity networks is possible.

687 S. 8(4) EnWG implementing Articles 10(2)(c), 15(2)(c), 17(c) Electricity Directive 2003, Articles 9(2)(c), 13(2)(c), 15(c) Gas Directive 2003. See also Articles 10(2) (transmission) and 15(2) (distribution) Electricity Directive, Articles 9(2) (transmission) and 13(2) (distribution) Gas Directive.

688 Unbundling Note, n. 448, p. 11.

689 Services such as accounting, finances, human resources and legal may be shared amongst the divisions of the vertically integrated energy supply undertaking if the sharing does not impair the network operator's independence, *ibid*., 9; BT-Drs. 15/3917, n. 683, pp. 53–4. Prices for such services have to be reasonable and at arm's length, and be detailed in service agreements in order to avoid potential cross-subsidization, see F Säcker, 'Entflechtung von Netzgeschäft und Vertrieb bei den Energieversorgungsunternehmen: Gesellschaftsrechtliche Möglichkeiten zur Umsetzung des sog. Legal Unbundling', (2004) DB 691, 695, and 'Aktuelle Rechtsfragen des Unbundling in der Energiewirtschaft', (2005) RdE 85, 92.

690 BT-Drs. 15/3917, n. 683, p. 51.

691 Obviously a scenario of combined legal and operational unbundling. See in this respect Säcker, n. 682, who explains that further reaching restrictions of the parent company's rights would violate current German company law (and its fundamental rights protected under the German Constitution).

692 SS. 8(4) 3rd sentence, 11–16a EnWG.

terms of the financial plan. Such general strategic competences allow the shareholders to ensure that the network operation subsidiary delivers a sufficient return on investment.[693] Therefore, there is considerable scope for control of the network operator by its parent. On the other hand, instructions with respect to day-to-day operations, maintenance or individual network construction or upgrading projects, which do not exceed the terms of the approved financial plan, are prohibited (financial independence).[694] It will thus be necessary to demarcate strategic from operational directions in each individual case. The objective will always be to prevent discriminatory access to energy networks and restrictions on competition. In practice, operational unbundling will require the legally independent network operator and its shareholder(s) to adapt their legal relationship, which will affect the details of control and management agreements as well as the powers of the shareholders' meeting and the supervisory board.[695]

Operational unbundling is not only concerned with the relationship of the unbundled legal entities but generally includes all measures serving the internal separation of integrated activities.[696] In order to safeguard the network operator's operational independence, special conditions for the employment of managers and other personnel at the network operating company have been introduced. Managers of the network operator must not participate in company structures that are directly or indirectly responsible for day-to-day operations in energy production or supply and they have to be treated in such a way as to ensure that they can act independently.[697] In order to protect managerial independence and

693 Malmendier/Schendel, n. 670, p. 373.

694 BT-Drs 15/3917, n. 683, p. 54.

695 As regards ways of optimizing the current German legal framework in order to achieve a higher degree of independence of system operators, Säcker, n. 682.

696 Meaning measures, which serve the strict separation and independent accountability of the activities concerned. Personnel of the activity concerned only thus report to the management of the respective internal activity.

697 See s. 8(2) 1st sentence and (3) EnWG implementing Articles 10(2)(a) and (b), 15(2)(a) and (b), 17(a) and (b) Electricity Directive 2003, Articles 9(2)(a) and (b), 13(2)(a) and (b), 15(a) and (b) Gas Directive 2003. With regard to management bonuses, the Commission rejects their admissibility by stating that '[t]he salary of the network management must not be based on the holding/supply company's performance and be established on the basis of pre-fixed elements related to the performance of the network company' (Unbundling Note, n. 448, 8). Accordingly, the holding of shares in an affiliated energy supply company are also supposed to be unacceptable. Germany, on the contrary, only sees a conflict of interest in terms of impaired independence if 'substantial parts' of the salary depend on the performance of non-network operation related divisions of the vertically integrated energy supply undertaking, see BT-Drs. 15/3917, n. 683, p. 54. Municipalities entering into (public or private) partnerships or incorporating a limited company (private: GmbH (*Gesellschaft mit beschränkter Haftung*) or public: AG (*Aktiengesellschaft*), see text after n. 780, must ensure according to the constitutional principle of (local) democracy that their governing councils have adequate influence resp. participation rights within the new undertaking. This may prove problematic as regards private law undertakings, which are required to be managed independently. In particular with

to ensure that the network operator has a sufficient number of staff, the German legislator has introduced three provisions, which have made the 2003 Energy Directives operational unbundling rules more precise. Managers[698] must be part of the organizational structure of the network operator[699]; the same applies to others with the power to make final decisions that are crucial for operating the networks in a non-discriminatory manner. As for managers, they must not participate in organizational structures that are directly or indirectly responsible for the day-to-day operations of energy production or supply.[700] Employees of other parts of the vertically integrated energy undertaking who perform tasks related to the operation of networks have to comply with the directions of the network operators' management.[701] Consequently, every person who has to be part of the organizational structure of the network operator[702] will have to be employed by the network operator, and is banned from being part of the company structures of energy production or supply. Thus, in general, managers and decision-makers of a network operator must not work for an energy production or supply company at the same time. The managing director of an energy supply company may, however, join the network operator's supervisory board because it remains the exclusive right of the shareholders to control their subsidiary.[703]

The unbundling measures also require the implementation of compliance programmes for employees of network operators[704], which each network operator

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regard to municipal network operations, which are not only required to be independent legally but also operationally, this seems to run counter to the intentions of current legislation. More generally discussing this conflict, D Ehlers, 'Empfiehlt es sich, das Recht der öffentlichen Unternehmen im Spannungsfeld von öffentlichem Auftrag und Wettbewerb national und gemeinschaftsrechtlich neu zu regeln?', in Deputation des Deutschen Juristentages (ed.), *Verhandlungen des vierundsechzigsten Deutschen Juristentages in Berlin*, Gutachten, Band 1, Teil E, 2002, p. 110.

698 Anyone who exerts influence on the network operator's business policy in terms of responsibilities, planning and operative decision-making. This includes high-ranking employees with decision-making powers in areas sensitive to discrimination, BT-Drs 15/3917, n. 683, p. 53, and Joint Guidelines, n. 680, p. 17. The Joint Guidelines include every person rendering decisions that can be relevant to transparent and non-discriminatory network operations, Joint Guidelines, n. 680, pp. 17–8. The distinction between 'managers' and 'decision-makers' is important because only the formers' professional independence is explicitly protected (s. 8(3) EnWG).

699 S. 8(2) 1st sentence EnWG.

700 *Ibid*.

701 S. 8(2) 2nd sentence EnWG.

702 S. 8(2) 1st sentence EnWG.

703 Unbundling Note, n. 448, 8. In its 2007 monitoring report, n. 125, the BNetzA establishes that in Germany there is not so much a problem with the implementation of legal unbundling by the vertically integrated energy supply undertakings but rather some contentious issues as regards operational and informational unbundling, which still require tackling.

704 S. 8(5) EnWG implementing Articles 10(2)(d), 15(2)(d) and 17(d) Electricity Directive 2003, Articles 9(2)(d), 13 (2) (d) and 15(d) Gas Directive 2003. See also Joint Guidelines, n. 680, pp.

has to adopt according to its individual discriminatory potential.[705] German legislation also prescribes informational unbundling in order to prevent commercially sensitive data, in particular customer data from being disclosed to the affiliated energy supply company.[706] With regard to IT systems, confidentiality may be safeguarded by introducing so-called Chinese walls regulating personal access, which can often be implemented without purchasing new IT systems.[707] Accounts unbundling tops the unbundling measures off by mandating the installation of separate accounts for the different activities of the vertically integrated energy supply undertaking. Every activity has to be accounted for as if it were pursued in separate companies.[708] Substantial transactions between associated undertakings have to be disclosed separately.[709]

Under German law, the public limited company (*Aktiengesellschaft*) appears to be the most suitable legal form to ensure the efficiacy of the unbundling requirements of the current legislative framework for the energy sector. Section 76(1) Aktiengesetz[710] confers upon the executive board a great degree of independence from the supervisory board where the shareholders are represented.[711] The managing directors of a private limited company (*Gesellschaft mit beschränkter Haftung* – GmbH), by contrast, are bound to follow the

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705 H Lecheler, J Herrmann, 'Energierechtliches Unbundling und EG-Wettbewerbsrecht', (2005) WuW 482, 485. German network operators can rely on a model compliance programme drafted by the three German associations of energy network operators, see Malmendier/Schendel, n. 670, p. 379.

706 See s. 9 EnWG implementing Articles 12 and 16 Electricity Directive 2003, Articles 10(1) and 14(1) Gas Directive 2003. As regards the problems the BNetzA faces with the appropriate implementation of operational and informational unbundling in Germany, see n. 703.

707 Unbundling Note, n. 448, p. 15; BT-Drs. 15/3917, n. 683, p. 55. The BNetzA has proposed a method of data processing, which would clearly bar access to network data by the vertically integrated energy supply division, see S Gras, 'Die Entflechtung nach §§6–10 EnWG', presentation, Bonn, 27 October 2005, pp. 14–6; see also Malmendier/Schendel, n. 670, p. 378.

708 S. 10 EnWG implementing Article 19 Electricity Directive 2003, Article 17 Gas Directive 2003. Accounts unbundling was first prescribed in 1998 for electricity in s. 9 EnWG 1998 and in 2003 for gas in s. 9a EnWG 1998.

709 S. 10(2) EnWG.

710 Public Limited Company Act (Aktiengesetz – AktG) of 6 September 1965, BGBl. I, p. 1089, as amended.

711 See also Säcker, n. 30, suggesting that in order to enhance the independence of vertically integrated network operations, certain provisions of the Aktiengesetz (AktG) dealing with supervisory boards should be applied to private limited companies (GmbH) as well. The latter is the legal form of the electricity transmission network companies of E.On, Vattenfall and RWE with some gas network companies of EnBW, E.On and RWE also incorporated as GmbHs. Säcker claims that in doing so the proposals of the Commission with respect to the introduction of ISOs would become superfluous (at least for Germany), also invoking fundamental rights concerns. The explanations given in the main text are also meant as a basis for the elaborations on *Effective and Efficient Unbundling* (see Introduction) towards the end of this chapter.

directions of its shareholders, in general as well as in individual cases.[712] However, restrictions of shareholders' rights are widely considered possible with regard to the above issues, which potentially conflict with the requirements of operational unbundling and confidentiality.[713] The most straightforward reason in support of this view is that the EnWG is legislation special to, and entered into force later than, the GmbHG.[714]

Network operators: obligations and access regulation

The terms and conditions of connection and access to the networks (but not gas storage) have to be adequate, non-discriminatory, transparent and no less favourable than what is required by the network operator in comparable cases either within the (vertically integrated) energy undertaking to which it belongs or from affiliated or associated undertakings. Energy network operators are responsible for providing secure and reliable energy networks.[715] Sections 22 and 23 EnWG set out transparent and non-discriminatory rules for network operators balancing the electricity and gas flows in their networks; transmission system operators have to tender for the energy required for balancing.

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712 See ss. 37 and 47 GmbHG (Gesetz betreffend die Gesellschaften mit beschränkter Haftung – Limited Liability Companies Act of 20 April 1892, RGBl., p. 477, as amended). These two legal forms can be considered as the most suitable under German law, in the context given. For further suitable forms, see Volz, n. 670, pp. 179, 180. Consequent to what has just been said in the main text, if a shareholder holds a majority stake in the network operator GmbH, as will usually be the case with the holding company of vertically integrated energy supply undertakings, such a shareholder is able to instruct the managing director(s) of the network operator. In this context, GmbH shareholders also have the right to have access to the company's files, i.e. obtain any information they require, see s. 51a(1) GmbHG. See in more detail, Volz, n. 670, pp. 173 *et seq.* These two issues seem to conflict with the managerial independence mandated by operational unbundling and the confidentiality requirement.

713 See Malmendier/Schendel, n. 670 , p. 380, with further references, and Volz, *ibid.*

714 For a concise overview of further reasons pro and contra, see Malmendier/Schendel, *ibid.* It is argued that the GmbH's articles of association do not need to be adapted to comply with the operational unbundling requirements because these requirements would automatically invalidate any conflicting directions, information requests and dismissals by shareholders of the network operator, see Säcker, n. 689, (2005) RdE 85, 87–90; U Ehricke, 'Unbundling und Vereinbarkeit der Gesellschaftsform einer GmbH', (2004) IR 170–172. See also Malmendier/Schendel, n. 670, p. 382. However, this seems to contradict the fact that the unbundling provisions are not self-executing but require implementation by the vertically integrated energy supply undertaking. Following the latter argument would call for the supervision of the BNetzA and the state regulatory agencies, which are competent to review the compliance with the unbundling provisions of the EnWG and, thus, the articles of association of every network operator incorporated as a GmbH, see s. 54(2) no. 4, (3) EnWG.

715 SS. 13 and 14 EnWG for electricity transmission and distribution, respectively, and ss. 16 and 16a EnWG for gas transmission and distribution, respectively.

Network operators are obliged to connect end consumers as well as electricity and gas supply networks of the same or a lower voltage/pressure level, and to connect generation and storage facilities to their network.[716] The connection can be refused if it is impossible or unreasonable for operational or other commercial or technical reasons taking into consideration the aims laid down in section 1 EnWG.[717]

Two of the central objectives of German energy law are to achieve secure and reliable as well as sustainable energy supply, both to the greatest extent possible.[718] As regards sustainability, Germany has chosen to impose on network operators the obligation to grant priority network access to their networks for electricity generated from renewable energy sources (RES)[719] and combined heat and power (CHP).[720] This obligation must also be taken into account in the event

716 S. 17 EnWG. In contrast, s. 18 EnWG establishes a general duty to connect for operators of networks for the general supply of end consumers. Such operators have to publish general terms and conditions for the connection of end consumers to the low voltage/pressure networks and for their use of the connection. For further details, see also the Regulations listed in n. 660. In summer 2007, the KraftNAV entered into force, which makes easier and accelerates the connection of new power plants of new market entrants in particular to the electricity networks, see in greater detail nn. 344, 615 (and accompanying text). This is safeguarded by the introduction of the new competition law provision of s. 29 GWB, see n. 749 and accompanying text. See also the monitoring report 2007 of the BNetzA, n. 125.

717 S. 21b EnWG has also in principle liberalized the metering trade. Upon request of the user, the installation, operation and maintenance of metering appliances and the measuring of the energy supplied can be carried out by a third party other than the network operator.

718 See s. 1(1) and (2) EnWG.

719 See s. 4(1) EEG (Gesetz zur Neuregelungen des Rechts der Erneuerbaren Energien im Strombereich (Erneuerbare-Energien-Gesetz – Renewable Energy Sources Act) of 21 July 2004, BGBl. I, p. 1918, as amended). This obligation comprises of priority purchase of electricity exclusively generated from RES and the prescription of minimum prices (feed-in tariffs) in order to afford RES generators preferential treatment (also called 'take and pay' obligation), and of RES plants to be connected to the next grid available, even if the grid has to be extended (if reasonable). Ultimately, the TSO is obliged to take and pay for the electricity from RES (after deducting avoided network charges), usually from the DSOs who initially took and paid for it. The cost of connecting to the grid is borne by the plant operator (but see s. 17(2) EnWG: the connection between the transformer stations of offshore wind generation farms and the next suitable connecting points to the grid on land has to be provided and paid for by the network operator concerned), the cost for reinforcing the grid by the network operator. The network operator's cost is passed through on to the end consumer as part of the network access charges. See in greater detail, Brunekreeft/Ehlers, n. 8. See also Mitchell/Bauknecht/Connor, n. 583.

720 See s. 4(1) KWKG (Gesetz für die Erhaltung, Modernisierung und den Ausbau der Kraft-Wärme-Kopplung (Cogeneration Modernisation Act) of 19 March 2002, BGBl I, 1092 as amended). CHP generation is also entitled to connect to the nearest network (even if a (reasonable) extension or reinforcement of the grid is necessary) and to be remunerated according to a feed-in tariff. The KWKG also provides for a settlement mechanism similar to that of EEG; the costs incurred by the network operator are also passed through to the end consumer.

that the security and reliability of the electricity supply system is disturbed or at risk.[721]

The core issue of the new EnWG is the introduction of regulated network access. The new regime includes the requirement to obtain prior approval of network charges[722], which is set out in more detail in the accompanying Regulations.[723] The network users enjoy a right to network access.[724]

In the gas sector, the EnWG provides for an entry-exit system, meaning that gas network operators have to offer feed-in and feed-out capacities, which enable network access without the need to enter into a contract for a particular transport path, and which can be individually used and traded.[725] In contrast, access to gas pipelines coming from gas production sites (*vorgelagerte Rohrleitungsnetze*) and to gas storage facilities is subject to negotiations. Thus the resulting access charges are not subject to prior approval by BNetzA.

The terms and conditions, and the charges for network access must be reasonable, nondiscriminatory and transparent, and no less favourable than those that, in comparable cases, a network operator charges its own company or affiliated or associated undertakings, both in the way they are calculated (*kalkulatorisch*) and in real terms (*tatsächlich*).[726] For the first time, charges have to be drawn up on the basis of the cost of operating the network business and have to reflect the costs of an efficient and structurally comparable network operator. In principle, incentives to provide an efficient output have to be taken into account as well as the need for a reasonable, competitive and risk-adequate rate of return on capital, subject to the stipulations of the NEVs[727], which may depart from this cost-based determination of network charges.

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721 See ss. 13(1) (for transmission) and 14(1) (for distribution) EnWG.

722 SS. 20 to 23 EnWG. The BNetzA has already used its new power to lower network charges considerably. It has, for instance, cut the network charges of the four German electricity transmission operators E.ON, RWE, EnBW and Vattenfall by between 8 and 18%. As regards gas network charges, two E.ON subsidiaries have had to accept reductions between 9.5 and 11%. See further www.bundesnetzagentur.de (for electricity and gas network charges). There are now, however, changes in the way in which network charges are calculated and the NZV Strom and NZV Gas, n. 659, introduce standardization and give the regulator powers to intervene, see ss. 27 and 28 NZV Strom and ss. 42 and 43 NZV Gas. See also s. 30 NEV Strom resp. Gas, n. 659, detailing the regulator's power to determine the exact content of certain balance sheet and accounts items.

723 See n. 659.

724 S. 20(2) EnWG.

725 S. 20(1)(b) EnWG. Previously, network access charges were calculated on the basis of individual transport routes.

726 S. 21 EnWG.

727 Regulations concerning the charges for access to the electricity and gas supply networks, see n. 659.

Because the EnWG deals with the calculation of network charges in abstract terms, the very detailed NEVs play an important role. Section 21a EnWG already provides for the possibility of deviating from a cost-based calculation of network charges, allowing for the introduction of incentive-based regulation.[728] Incentive regulation[729] basically means that once network access charges are approved, they remain unchanged for a prescribed regulatory period (two to five years) setting upper limits for network charges or for total revenue from these charges, based on criteria of efficiency. As a result, network operators increasing their efficiency will have the incentive of higher profits. Incentive regulation will enter into force in Germany at the beginning of 2009.[730]

Finally, energy supply companies, which are the universal suppliers of household customers in a given network area (*Grundversorgung*), have to publish general terms and conditions and generally applicable prices within low voltage/pressure networks, and must supply all household customers accordingly.[731] The duty to provide universal service does not require the supply company to operate the corresponding network for general supply.[732] Universal service providers are companies that supply the majority of the household customers on a certain date (on 1 July of every third year, starting with 1 July 2006). This is not necessarily the traditional municipal energy supplier.[733]

Regulatory procedure and judicial review

German regulatory authorities have acquired extensive powers to supervise the energy sector.[734] All decisions of these authorities are the result of a special administrative procedure as set out in sections 65 *et seq.* EnWG. This procedure resembles court proceedings and takes place before one of nine ruling chambers (*Beschlusskammern*). The decisions of the regulatory authorities can be appealed

728 Brunekreeft/Bauknecht, n. 656, ch. 8.3.1., point out that it is not clear what incentive-based regulation means, and how incentive-based regulation differs from cost-based regulation. As to the criticism of the application of these types of regulation from a legal perspective, see J-C Pielow, 'Auslegungsfragen zur Einführung der Anreizregulierung nach § 21a EnWG', Bochumer Forschungsberichte, Band 29, 2007.

729 As reflected in s. 21a(2) and (3) EnWG.

730 SS. 21a(6), 118(5) EnWG. See also n. 662.

731 S. 36 EnWG. This duty reflects the universal service obligation of the energy supply sector and is complemented by the Regulation named second in n. 662. For supply of last resort and exemptions from universal supply, see ss. 37 and 38 EnWG and the Regulation, *ibid*., which is based on s. 39 EnWG.

732 As regards the obligation to connect household customers, which is a separate obligation of network operators, see *supra*.

733 See in this respect *supra* and n. 768.

734 For the power of the regulatory authorities to give directions to energy supply undertakings, see also the general legal basis in s. 65 EnWG.

(*Beschwerde*)[735], but this does not lead to the suspension of the execution of the decision unless so ordered by the appeal court. The competent appeal courts are the competition law divisions of the Higher Regional Courts (*Kartellsenate der Oberlandesgerichte*) where the respective regulatory authority is situated.[736] The extent of judicial control of the decisions of the regulatory authority is heavily disputed: on the one hand, there is an argument for a wide margin of appreciation (*Beurteilungsspielraum*) of the regulatory authorities, on the other hand, Article 19(4) GG requires as a matter of principle that decisions by the administration are subject to a comprehensive judicial review.[737]

Following the establishment of the BNetzA in July 2005, the demarcation of powers and the relationship between the BNetzA (and possible regulatory authorities of German states) and the BKartA (and corresponding state authorities) with respect to the supervision of non-discriminatory TPA has gained importance.[738] Sections 20 *et seq.* EnWG and sections 33 and 19(4) no. 4 GWB grant the right to access energy networks but do so on very different legal bases[739]: the former operates as an *ex ante* regulatory tool, the latter as an *ex post* competition law measure.[740]

Before the BNetzA became operational in July 2005, the BKartA and the competent state authorities were generally responsible for preventing abusive practices by dominant firms, including the setting of energy prices (which included network connection and access charges). This has changed with the new EnWG. Sections 19 and 20 GWB[741] are now no longer applicable insofar as the

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735 See ss. 75 *et seq.* EnWG.

736 The competent court for the BNetzA is the *Oberlandesgericht* (Higher Regional Court) *Düsseldorf.*

737 For further discussion, see M Burgi, 'Das subjektive Recht im Energie-Regulierungsverwaltungsrecht', (2006) DVBl. 269, and J-C Pielow, 'Wie "unabhängig" ist die Netzregulierung im Strom- und Gassektor?' (2005) DÖV 1017.

738 No elaborations are made here on other responsibilities of German competition authorities, such as merger control.

739 S. 19 GWB introduced the so-called 'essential facilities' concept into German law, according to which it may be considered an abuse of a dominant position (unless justified) if the operator of an energy network (or other *infra*structure facility) denies access to a (potential) competitor on an upstream or downstream market without which he would not be able to compete there. This is in addition to the direct enforceability of Articles 81 and 82 EC in Germany law. See Ehlers, n. 656, and Heinen, n. 287. See also M Dreher, 'Die Verweigerung des Zugangs zu einer wesentlichen Einrichtung als Mißbrauch der Marktbeherrschung', (1999) DB 833.

740 Brunekreeft/Bauknecht, n. 656, provide an in-depth analysis of the new EnWG from an economist's point of view and a very instructive overview of the structure of the German energy sector.

741 In general, these provisions set out the legal framework for controlling abusive practices and the prohibition of discriminatory behaviour and undue impediment.

provisions of the EnWG, in particular of Part 3 of the EnWG[742] or Regulations based thereon, are conclusive. Published (and thus authorized) network charges bind the BKartA and state competition authorities in proceedings concerning energy prices for end consumers.[743] As Article 82 EC is generally applicable, even in regulated sectors, the competition authorities remain solely responsible for enforcing Article 82 EC.[744] Consequently, recent interventions of the competition authorities based on Article 82 EC (as, for instance in the *Marathon* case[745]) show that refusal of access to essential *infra*structures can still be remedied under competition law. They also show that this can be done parallel to and in coordination with national regulators, which can impose more detailed access rules.[746] Although *ex ante* regulation based on the 2003 Energy Directives and their implementation into national law will gradually reduce the need for antitrust intervention, the relevance of competition rules will not diminish. *Ex ante* regulation will never be able to control every situation in which network operators may be tempted to (ab)use their power.[747]

As regards the exercise of the general energy price control powers of the German competition authorities[748], the BKartA has now been empowered to review energy prices if it deems them to be unreasonable. Section 29 GWB, which is valid until 2012 initially, inter alia introduces the shifting of the burden of proof

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742 Titled *Regulierung des Netzbetriebs*, which translates as regulation of network operations. Part 3 EnWG in particular contains provisions about network connection and access, which are also the necessary legislative basis for Regulations detailing these provisions.

743 SS. 130(3) GWB, 111 EnWG.

744 See s. 58 EnWG for the collaboration between regulatory and competition authorities. On this issue see also, as regards the old law, Pritzsche/Klauer, n. 656, pp. 155 *et seq.*, and for the draft EnWG, see Klauer, n. 656, pp. 91–7. For consumers associations' right to initiate proceedings against abusive practices and their procedural rights, see ss. 66, 75 and 79 EnWG; for the regulatory authorities' *ex post* regulatory powers, ss. 94 *et seq.* EnWG and Pritzsche/Klauer, n. 656, p. 150. See also the elaborations in the context of the *Deutsche Telekom* case, n. 210 and accompanying text.

745 See in more detail, van der Woude, n. 187, no. 3.214, and 'Recent Developments in EC Competition Law – Facing the Network', in M. Roggenkamp, U. Hammer (eds), *European Energy Law Report II*, 2005, ch. 2, pp. 15 *et seq.*, 25.

746 Article 82 EC is generally applicable, even in the regulated sectors, and the competition authorities remain solely responsible for its enforcement. See s 58 EnWG for the collaboration between regulatory and competition authorities. For consumers associations' right to initiate proceedings against abusive practices and their procedural rights, see ss. 66, 75 and 79 EnWG; for the regulatory authorities' *ex post* regulatory powers, ss. 94 *et seq.* EnWG.

747 Van der Woude, n. 187, no. 3.214. F Säcker, 'Die wettbewerbsrechtliche Beurteilung von Netzkooperationen, Beteiligungen an Netzgesellschaften, Netzpacht und Betriebsführungsverträgen', (2005) ZNER 270, however, doubts that such a temptation is high because such behaviour would be economically and commercially irrational in the current European and German regulatory setting.

748 Deduced from s 19(4)(2) GWB. This general price control does, however, not extend to the published network charges whose control falls into the remit of the BNetzA.

onto the energy supply undertakings as regards the justification of price increases and the immediate enforceability of the BKartA's decisions in this respect. It is supposed to enable the competition authorities to detect and fight abusive behaviour in the energy supply sector more easily and more effectively.[749] This is the response of the German government to soaring energy prices[750] given the expiration of the Federal Tariff Ordinance Electricity (*Bundestarifordnung Elektrizität* – BTO Elt) on 1 July 2007, which served as the statutory basis for authorized increases in electricity prices for household customers.[751]

Further, the BKartA complements the BNetzA's endeavours to enhance TPA to the German gas networks by restricting the validity of long-term gas supply contracts (LTCs).[752]

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749 See www.bmwi.de/BMWi/Navigation/Presse/pressemitteilungen,did=230118.html.

750 In particular electricity prices initially decreased after 1998 when the EnWG was first revised. Subsequently, however, consumer prices for natural gas and electricity began to rise steadily and significantly. This is mainly due to rising world market prices for primary energy sources, an increase in financial burdens resulting from emerging special taxes on environmental protection (so-called *Ökosteuer*) and the shifting of costs for the promotion of renewable energy sources and CHP onto all electricity consumers. These financial burdens reached a level of 40 per cent of the electricity price in 2005 (25 per cent in 1998). The implementation of CO_2 emission rights trading in Germany also contributed to this. In addition, VAT was lifted from 16 to 19 per cent at the beginning of 2007. Currently, German electricity prices rank in the upper third of the price range in the EU. Natural gas prices for household customers are somewhere in the centre of the price range whereas gas tariffs for industrial customers are amongst the lowest in the EU. For further details, see Federal Ministries of Economic Affairs and Technology and for Environment, Protection of Nature and Nuclear Safety (eds), *Energieversorgung für Deutschland*, March 2006, pp. 27 *et seq.*; see also the international comparison of energy prices in Federal Ministry of Economic Affairs and Technology (ed.), *Energiedaten – Nationale und Internationale Entwicklung*, updated from time to time.

751 The introduction of s. 29 GWB was severally criticized by the Wissenschaftlicher Beirat des Bundesministeriums für Wirtschaft und Technologie (Academic Advisory Board of the Federal Ministry for Economic Affairs and Technology) in a letter to the Secretary of State for Economic Affairs and Technology, M Glos, on 20 November 2006. It rejects this amendment of the GWB because such a change would inhibit competition in the energy sector. To assess abuse of market power the current state of the law would suffice, which already empowers the competition authorities to set prices at levels which would apply if there was effective competition: s. 19(4)(2) GWB. High prices and high profit were, for themselves, no reason for the State to intervene, in particular so when similar price trends could be observed in all Member States in the European Union.

752 In Germany, the BKartA focuses mainly on long-term gas supply or downstream contracts, whereas the European Commission also scrutinizes long-term gas purchase or upstream or import contracts with gas producing countries. The latter clearly reflects the conflict between promoting competition in the EU and securing supply security. See also Article 27 Gas Directive 2003 as regards the possibility of granting exemptions from the obligation to allow TPA in the context of take-or-pay commitments. See also nn. 43, 197. Generally, long-term gas supply contracts can be prohibited according to Article 81 EC as they usually affect trade between Member States. These contracts can, however, also contravene Article 82 EC in that a supplier may abuse its dominant position by insisting on supply terms of unreasonable duration and/or forcing contractual partners to accept an unreasonably high coverage of their

The relationship between regulatory and competition authorities in Germany can also be better understood by examining the ways consumers are protected from excessive energy prices. In principle, there are three such ways: first, competition law enforcement[753], secondly, protection via legal instruments based on the EnWG[754] and, thirdly, individual actions to civil courts.[755]

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needs by that supplier. In 2006, the BKartA, n. 43, ruled that E.ON Ruhrgas had to cease, by 30 September 2006, the enforcement of all terms in gas supply contracts with regional and local gas suppliers found to violate competition law. This ruling had repercussions for the whole sector because of its general prohibition (accompanied by several safeguarding measures) of contract terms of more than four years where *de facto* supply exceeds 50 per cent, or of more than two years if *de facto* supply exceeds 80 per cent of a contractual partner's overall need. For a critical view see Kühne, n. 137. On p. 69, he rightly criticizes the BKartA's policy as no longer protecting the functioning of existing markets but also forcing open new markets even if commercially detrimental to downstream suppliers. This is because the BKartA prohibits additional supply contracts between the majority supplier and the downstream supplier if they hit the thresholds just outlined. This may lead to the prohibition of contracts, which are more lucrative to the downstream supplier than those offered by competitors. Thus, tensions arise between the principle of freedom of contract on the one hand and the idea of competition on the other. See also L Hancher, 'Power plays: the end if the line for long-term energy contracts in Europe?', Oxera Agenda, May 2009.

753 As increases in energy prices can constitute an abuse of a dominant position according to s. 19(4) no. 2 GWB, which sets out that an abuse takes place if a dominant undertaking demands payment or other business terms, which they would not be able to claim if effective competition was in place. In addition, as has just been outlined above, the BKartA can check such prices on its own account on the basis of the new s. 29 GWB. SS. 33–34a GWB (to be read in connection with ss. 54–96 GWB, which contain procedural issues) provide for courses of action against such an abuse, such as an action in tort (s. 33 GWB), according to which individuals or associations representing business group interests (*Verbände*) can claim damages or file for a cease and desist order (*Unterlassung*).

754 With respect to allegedly excessive network charges, the new EnWG provides causes of action for the BNetzA or individuals and associations in ss. 30–33 EnWG (to be read in connection with ss 65–108 GWB, which contain procedural issues). See in greater detail, G Kühne, 'Gerichtliche Entgeltkontrolle im Energierecht', (2006) NJW 654, 656. See also ss. 130(3) GWB, 111 EnWG.

755 Energy consumers also frequently resort to refusing to pay the difference between the old and the new price, or even the entire price, and to forcing the energy supply undertaking to sue for recovery under civil law (normally the supplier is not permitted to cut off supply). This can be a worthwhile route of action because the legal basis for energy price increases is normally a contractual agreement, which authorizes the energy supplier to unilaterally adjust prices when costs are increasing. In such a case, section 315(1) BGB (Bürgerliches Gesetzbuch (German Civil Code) of 18 August 1896, revised version (*Neufassung*) published on 2 January 2002, BGBl. I, p. 42 (2909); 2003 I, p. 738) becomes applicable, which stipulates that the unilateral determination of contractual obligations, here the amount of monies to be paid, must be exercised in fair manner. According to section 315(3) BGB, such determination is only binding on the party concerned if it is fair (*Billigkeit*). If the determination is not fair it is for the courts to determine the extent of the obligation in question. The Federal Supreme Court for Civil Matters has, for instance, recently ruled on the adequacy of charges for access to electricity networks holding that s. 315 BGB is concurrently applicable with the competition law provisions on abuse of a dominant position, see BGHZ 164, 336. See also J Held, 'Überhöhte Preise auf dem Wärmemarkt? – Billigkeitskontrolle von Erdgas- und Fernwärmetarifen nach § 315 BGB', (2004) NZM 169, 171 (discussing the applicability of s. 315 BGB to gas and district

As an interim conclusion, it can be observed that the German competition authorities in general and the BKartA in particular have had much of their power transferred to the BNetzA and the state regulatory authorities as regards their responsibilities to prevent abusive network access tariffs. These are now controlled on the basis of the new EnWG. It remains to be seen how well the BNetzA is able to perform its tasks when faced with more than 1,500 electricity and gas network operators. It seems unlikely that the BNetzA will be able to continuously check and approve the access terms and charges of each of these operators, in which case the scrutiny of the energy markets by the BKartA remains important.[756]

III. CONSTITUTIONAL SETTING

The German Grundgesetz does not contain any specific reference to the energy supply sector.[757] Nonetheless, the Federal Constitutional Court (*Bundesverfassungsgericht*) already a long time ago ruled that security of energy supply is of the greatest general interest.[758] Permanent availability of energy is an 'indispensable prerequisite for the functioning of the economy' and an 'absolute common good'.[759] Accordingly, energy supply is a constituent of *öffentliche Daseinsvorsorge* (on the European level also called Service of General (Economic)

heating cases). Some voices in legal scholarship find, however, that remedies based on competition law or energy regulation exclude the applicability of s. 315 BGB, see Kühne, n. 754. Relying on the remedy of section 315 BGB is normally preferable because the burden of proof in civil proceedings lies with the party determining the price to be paid, i.e. the energy supplier as claimant, which means that in order to prove the fairness of the price determination the energy supplier has to disclose (elements of) its price calculation. See Kühne, *ibid*., pp. 656–7 (standard of proof in competition and civil law proceedings).

756 According to Brunekreeft/Bauknecht, n. 656, ch. 8.3.1, the problem of how to manage the regulation of this vast number of mostly very small energy distribution network operators 'could be by-passed by applying different types of regulation: a strict incentive-based regulation at federal level and a "loose" cost-plus approach at state level for many small utilities.' They continue: 'If all the small DNOs [distribution network operators] are also regulated by the same type of incentive regulation, it is unclear what is gained with splitting up the authority, while it opens the door for regulatory capture at state level.'

757 This is different, however, as regards *environmental* aspects of energy supply, such as environmental protection, climate change and the protection of fossil energy resources. Article 20a GG includes in German constitutional law 'the protection of natural bases of life' as a sort of policy objective: 'Mindful also of its responsibility towards future generations, the State shall protect the natural bases of life by legislation, and, in accordance with law and justice, by executive and judicial action, all within the framework of the constitutional order.'

758 BVerfGE 91, 186, 206.

759 See BVerfGE 30, 292, 323–4.

Interest)[760], which means that the individual must have certain individual goods available in order to live in dignity (*cf.* Article 1(1) GG).[761]

1. STATE RESPONSIBILITY AND ALLOCATION OF COMPETENCES

State involvement in the energy sector is a consequence of society's dependence on safe and cheap energy supply as well as of the technical, economic and ecological characteristics of the sector, i.e. network-bound electricity and gas supply requires planning (in terms of land use) and the prevention of abusive behaviour, energy production must always be available upon demand and production and generation facilities and transportation networks are investment-intensive and thus require a sound legal framework, which provides for stable long-term conditions (legal certainty). The immense environmental impact of electricity generation and energy transport through networks also has to be taken into account. Hence, both the Federal State and its subdivisions (*Länder* and municipalities) are deemed to hold a specific 'responsibility to guarantee' (*Gewährleistungsverantwortung*) the provision of services of general (economic) interest such as energy supply[762], also known as the State's responsibility for

760 Reflecting a variety of national concepts, i.e. for Germany the concept of *öffentliche Daseinsvorsorge*. This concept has been criticized, however as rather meaningless by J-C Pielow, 'Kommunalwirtschaftsrechtliche Sonderregelungen für gemeindliche Energieversorgungsunternehmen', in F Säcker (ed.), *Berliner Kommentar zum Energierecht*, 2nd ed., 2009, no. 13, which is even trueer now that many formerly exclusive tasks of the State and the public administration have been privatised. See also BVerfGE 107, 59, 93 *et seq.*, which confirms that services of general (economic) interest do not necessarily have to be performed by the State. Only such tasks, which the State has to fulfill through its own authorities as public tasks in a narrow sense, i.e. tasks conferred upon the State by the Constitution, cannot be privatized. The term "services of general economic interest" refers to "services of an economic nature, which are subject to specific public service obligations by virtue of a general interest criterion. The concept of services of general economic interest thus covers in particular certain services provided by the big network industries such as transport, postal services, energy and communications." See Communication from the Commission, 'White Paper on Services of General Interest', COM(2004) 374 final, Brussels, 12.5.2004, p. 22. In the area of energy, economic activities subject to special public service obligations are, for example, connection and access to energy networks and supply and other universal service obligations. With respect to German municipal and private energy supply undertakings, this primarily refers to the general obligation to connect according to s. 18 EnWG and/or to the obligation to provide a basic supply of energy (*Grundversorgungspflicht*) according to s. 36 EnWG. See also nn. 118, 768, 780 and accompanying text.

761 BVerfGE 66, 248, 258.

762 *Cf.*, e.g., E Schmidt-Aßmann, *Das allgemeine Verwaltungsrecht als Ordnungsidee*, 2nd ed., 2004, pp. 172 *et seq.* As regards the supply of energy, it is in principle the task of the federal State, the states (*Länder*) and the municipalities, to safeguard the continuous and country-wide supply of electricity and gas to the general public, of reasonable quality and price and, thus, on socially adequate conditions.

public *infra*structure (*Infrastrukturverantwortung*)[763], in order to safeguard the provision of services to be delivered via networks. It can be deduced from a principle of the German Constitution, which classifies Germany as a welfare state (*Sozialstaat*)[764], and from the State's duty to protect fundamental rights.[765] This means that even though public utilities are increasingly being privatized and liberalized, the State ultimately retains the responsibility to control these utilities in order to ensure public and universal services, which include the provision of sustainable and economically reasonable services.[766] It also remains responsible for the supervision of the market behaviour of the former monopolies, which often continue to hold a dominant position.[767]

However, this special responsibility of the State as regards the guarantee of energy supply is only a residual or last resort responsibility (i.e. if a supplier fails) which is considered to complement the primary role of private enterprise. In particular, no prerogative or exclusive right of the State (or public undertakings) can be deduced from this principle. Indeed, the term *Gewährleistungsverantwortung* has been developed in order to emphasize the fact that the provision of public utility services in times of liberalization and privatization no longer constitutes an exclusive task of the State but rather a matter for the society itself, i.e. especially of private undertakings.[768]

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763 Hermes, n. 641.

764 Article 20(1) GG stipulates: 'The Federal Republic of Germany is a […] *welfare* State'.

765 Reflected in particular in Article 1 GG (protection of human dignity) and Article 2 GG (right to life and to physical integrity). The duty of the State according to Article 109(2) GG to safeguard the macroeconomic balance of the State (*gesamtwirtschaftliches Gleichgewicht*) is sometimes also named as a basis for such responsibilities. On statutory level, the communal responsibility to guarantee the provision of certain services of general (economic) interest is reflected in the general duty of the municipalities to provide their citizens with the necessary public facilities for their economic, social and cultural well-being, which is traditionally deeply rooted on communal level, see J-C Pielow, 'Der Rechtsstatus von Stromversorgungsnetzen: "Öffentliche Einrichtung" oder Grundrechtsschutz des Betreibers?', (2000) RdE 45, 51.

766 See nn. 118, 731, 760, 768 and accompanying text.

767 With regard to the concept of *Gewährleistungsverantwortung* and its role in the energy and other network-bound sectors such as telecommunications and rail transport, see in greater detail, J Kühling, *Sektorspezifische Regulierung in den Netzwirtschaften*, 2004, and Pielow, n. 641, pp. 344 *et seq.*, both with further references.

768 This is what *öffentliche Daseinsvorsorge* means today. This principle merely serves as an *empirical* term for certain 'existential' services or services of general (economic) interest. It does not imply any private or public nature of the service in question. It can be compared to the British term of 'public utilities' or to the likewise *neutral* term 'services of general (economic) interest' as used in Articles 16 and 86(2) EC, and be contrasted to the legal concept of *service public* in France, which traditionally tends to regard 'existential' services as falling into the exclusive remit of the State. For a comparison of the German concept of *öffentliche Daseinsvorsorge* with the French principle of *service public*, see Pielow, n. 641, pp. 111 *et seq.* The *Gewährleistungsverantwortung* is, however, increasingly taking a back seat and is conferred upon all (even private) energy supply undertakings as can be inferred from the introduction of

Because energy supply in Germany constitutes a primarily private activity, public engagement in the energy sector is limited as regards the constitutional assignment of legislative and executive powers to the State but also by its duty to observe the fundamental rights (*Grundrechte*) of the stakeholders in this area.[769] With respect to the latter, the regulation of the energy sector must especially safeguard the energy market participants' freedom of occupation and economic activity (*Berufsfreiheit*) as set out in Article 12(1) GG and their right to property as set out in Article 14 GG.[770]

As a federal state, Germany allocates its legislative and executive powers both at federal (*Bund*) as well as at states' (*Länder*), regional and municipal level (see Article 20(1) GG). This division of powers is thus highly relevant for the energy sector.

The competence to pass legislation regulating the energy and the mining sectors is in principle attributed to the federal level as part of the right to regulate the economy (see Article 74(1) no. 11 GG). It covers the formulation of energy law in general and the regulation of the production, transmission, storage, distribution and supply of energy in particular.[771] The *Länder* may only legislate if the federal level has not made use of its competence. In practice, however, the *Bund* has fully exploited its legislative competences in the area of energy law so that little scope for state legislation remains.

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a general supplier for end consumers and a supplier of last resort in ss. 36 and 38 EnWG. See also nn. 731–733.

769 These rights may be invoked by individuals and by domestic legal persons (undertakings) against all acts of public authority and also before the Federal Constitutional Court (see Article 93(1) no. 4a GG). As regards the protection of foreign legal persons, nn. 906, 961 and accompanying text.

770 Thus, interferences in the energy sector by, for instance, the concept of unbundling, which is novel to German law, as well as the extent of regulation of network access introduced by the EnWG are highly controversial from a constitutional law point of view. For a first overview, see Schmidt-Preuß in Baur *et al.* (eds), *Unbundling in der Energiewirtschaft*, n. 539. See also the President of the Federal Constitutional Court, H-J Papier, 'Verfassungsfragen der Durchleitung', in U Büdenbender, G Kühne (eds), *Das neue Energierecht in der Bewährung*, Festschrift zum 65. Geburtstag von J Baur, 2002, pp. 209 *et seq.*, and M Schmidt-Preuß, *Substanzerhaltung und Eigentum*, 2003. See further *infra*. For more details concerning the increasingly 'multipolar' conflicts of interests and individual rights in a liberalized energy sector see Kühling, n. 767, pp. 488 *et seq.*, with further references; Burgi, n. 737.

771 Thus, this competence also extends to legislative matters concerning, for instance, energy installations and their safety, energy prices and taxes etc. Additionally, Article 74(1) nos 13 and 16 GG confer legislative competences with respect to energy research and competition law on the *Bund*.

Under German constitutional law federal or *Länder* governments[772] are only competent to issue statutory instruments (*Rechtsverordnungen*) if the content, purpose and scope of these regulations have been specified by a parliamentary law (see Article 80(1) GG). This again is highly relevant in the energy sector as, for instance, the EnWG contains numerous authorizations for executive bodies, in particular the Federal Ministry of Economic Affairs, to issue such statutory instruments but only within the boundaries of such authorizations.

As regards the particular issue of independent regulatory authorities, i.e. independent from political influences, under German constitutional law, these are difficult to establish. This is because such independency would conflict with the German reading of the principle of democracy as construed and provided for by Article 20(1) GG, which requires an uninterrupted chain of democratic legitimation from executive authority to Parliament, and which can be safeguarded by the BVerfG.[773] As a result, the Constitution prohibits areas free of ministerial supervision (*ministerialfreie Räume*).[774] Consequently, the BKartA and BNetzA are both divisions of the Federal Ministry of Economic Affairs and as such subject to its directions. A good example of how this system works is the 2003 merger of the former Ruhrgas AG with E.ON AG creating E.ON Ruhrgas AG, which was initially prohibited by the BKartA but later waived through on the basis of a special ministerial permission according to Article 42 GWB.[775]

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772 Executive competences are exercised by federal and *Länder* administrative bodies, whereby the vast majority of such competences are assigned to the *Länder*. Based on Article 87(3) GG, the *Bund* has, for instance, established the BKartA, which shares responsibilities with the competition authorities of the *Länder* (see ss. 49 and 51 GWB), and, with the entry into force of the EnWG, the BNetzA. As to the latter, see Gesetz über die Bundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und Eisenbahnen (Law on the Bundesnetzagentur for electricity, gas, telecommunications, postal and rail services) of 7 July 2005, BGBl. I, pp. 1970, 2009. In the energy sector, however, the BNetzA shares responsibilities with the *Länder* regulatory authorities, see ss. 54 and 55 EnWG and further *infra*. The execution of federal laws on energy matters is normally pursued by *Länder*. Planning procedures and permissions, such as are necessary for the construction of energy networks, are usually assigned to regional governments (*Bezirksregierungen*) as administrative subdivisions of the *Länder*. The *Länder* (and exceptionally also the *Bund*) may transfer administrative tasks to the regions (*Landkreise*) and municipalities (*kreisfreie Städte*), which then act as agents of the state (*übertragener Wirkungskreis*) and not within their own responsibilities (*eigener Wirkungskreis*) as guaranteed by Article 28 GG. As to the latter, see further *infra*.

773 Which is different for the UK where no such court exists, see further Part 2 Chapter 5 on Great Britain.

774 See Dreier in Dreier, *Grundgesetz*, Band 2, 2nd ed., 2006, Article 20, nos 113, 116. Specifically on the BNetzA, see T Mayen, 'Verwaltung durch unabhängige Einrichtungen', (2006) DÖV 45. See also Tettinger/Pielow, n. 663.

775 The BNetzA is to a great extent more "independent" because it only has to follow general directions of the Secretary for Economic Affairs, see s. 61 EnWG.

2. MUNICIPAL ENERGY SUPPLY

Most of the approximately 900 energy supply undertakings in Germany are small and medium sized *municipal* undertakings, often called *Stadtwerke*, which underlines the traditional involvement of municipalities in the German energy sector.[776] Traditionally, the use of public roads for supply lines is governed by private law concession contracts on the basis of which energy supply undertakings have to pay concession fees.[777] This system, together with the so-called *Demarkationsverträge*[778], has allowed municipalities to establish monopolistic supply structures within their territories and to maintain their dominance in the supply of energy.[779]

Apart from ensuring local energy supply, a central motive for municipalities to engage in this sector is revenue generation to finance less profitable municipal services such as public transport, waste and water services, which as services of general *economic* interest are traditionally counted towards '*öffentliche Daseinsvorsorge*' and pursued by municipalities. This is why most of the *Stadtwerke* have been – and still are – designed as undertakings, which provide a wide variety of public utility services (*kommunale Verbundunternehmen*). As has already been outlined above, revenues especially from energy sector operations are often also used for (horizontal) cross-subsidization of services of general interest such as public swimming pools, libraries, theatres, parks etc.[780]

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776 Compared to the tasks of municipalities in other areas of public supply and disposal (such as water, public transport, sewage, waste etc), which are explicitly provided for by law there are hardly any precise references in the law to energy supply as a task to be pursued by municipalities. This is because the regulation of the energy supply industry in Germany has traditionally been neutral with regard to who is supposed to pursue energy supply and how this should be organized, see Pielow with further references.

777 German municipalities traditionally control public ways. Concession fees amount to approx. 3.5 billion Euro each year.

778 In 1957, the Law against competition restraints, n. 654, exempted demarcation and exclusive concessions agreements, on which these supply areas were based, from the prohibition on forming cartels and abusing one's monopoly position (original, now repealed s. 103(1) GWB). These provisions secured the monopoly position of the municipal energy supply undertakings over decades, and with it their steady income including concession fees. It was only in April 1998 with the entering into force of the 1998 Energy Industry Act as a consequence of the implementation of the EC Electricity Directive 1996, n. 653, that this protective environment in which communal energy supply undertakings had operated for so long changed radically. As a result of the deletion of the competition law privileges of demarcation agreements and the introduction of (negotiated) TPA by s. 6 EnWG 1998, the role of the communal ESUs turned from being the exclusive energy supplier of their municipality towards that of a competitor in the German electricity and gas sectors from April 1998 and Mai 2003 respectively (which saw the implementation of the 1996 Electricity and the 1998 Gas Directives, respectively, into German law). See also n. 654 and accompanying text.

779 See in greater detail, Pielow/Koopmann, n. 653, nos 8.28 *et seq.*

780 I.e. normally social tasks pursued on a non-profit basis. See the contributions in G Püttner (ed.), *Der kommunale Querverbund*, 1995. As to the questions of state aid, see n. 785. EC Treaty

Constitutional setting

Municipalities are public institutions and as such they may not invoke fundamental rights under the Constitution.[781] The extent of the commercial activities that municipalities are therefore allowed to pursue derives from the public and constitutional law provisions dealing with municipalities.

It is commonly assumed that the supply of residents with electricity and gas falls within the 'affairs rooted in the local community'[782], which is a matter of local and thus autonomous self-government guaranteed by Article 28(2) GG and similar provisions in the constitutions of the *Länder* (*Selbstverwaltungsgarantie*).[783] This guarantee, however, only establishes a principal administrative responsibility of the municipalities and does not say anything about whether municipalities are obliged or entitled to perform energy supply tasks themselves or whether they even possess an exclusive right to do so.[784] Moreover, the constitutional protection of local self-government does not guarantee the continuance of existing municipal undertakings nor does it exempt them from competition arising in the course of liberalization.[785]

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provisions are not applicable to services of general (non-economic) interest, see J Ruthig, S Storr, *Öffentliches Wirtschaftsrecht*, 2005, no. 501. According to Pielow, n. 765, the traditional distinction between economic and non-economic activities is no longer applicable. Typical services of general interest (*Daseinsvorsorge*) such as supply and disposal services, in particular energy supply, have in the meantime also been offered by (private) third parties so that nowadays municipalities can *per definitionem* only perform them as an economic activity and thus as a service of general economic interest.

781 The extent to which undertakings, which are (partly) owned by municipalities, can rely on fundamental rights protection under the German constitution is, however, debated, see J Kämmerer, *Privatisierung*, 2001, p. 464; M Möstl, *Grundrechtsbindung öffentlicher Wirtschaftstätigkeit*, 1999, p. 89. As to the right of undertakings such as *Deutsche Telekom AG*, which are (*de facto*) controlled by public institutions (see in this respect, more generally, Ruthig/Storr, n. 780, nos 446–8) to invoke fundamental rights protection, see the decisions of the BVerwG, BVerwGE 114, 160, 189; 19 December 2003, 20 F 9.03; BVerfGE 120, 54, 59. See also, however, n. 940 and accompanying text. On the other hand, public or municipal undertakings can rely on the freedoms of the EC Treaty, whose main purpose it is to safeguard non-discriminatory access to the internal market.

782 According to the principle of general competence (*Allzuständigkeit*) there is a presumption in favour of the municipalities' competence to accomplish all local matters themselves, which also reflects the political and democratic aspect of the citizen's participation in accomplishing public tasks, see Ruthig/Storr, n. 780, no. 128.

783 *Cf.* Article 28(2) 1st sentence GG: 'The municipalities shall be guaranteed the right to manage all affairs of the local community under their own responsibility within the limits of law'. As to *Länder* law, see, for instance, Article 83(1) of the Constitution of the State of Bavaria.

784 P Tettinger, 'Recht der Energiewirtschaft', in R Schmidt (ed.), *Öffentliches Wirtschaftsrecht – Besonderer Teil 1*, Springer, Berlin, 1995, § 7, p. 698. Similarly, the fact that municipalities own the public highways on their territory may not be interpreted such that this would confer any privilege upon them with respect to the energy supply networks built on or underneath them, see E Huber, *Wirtschaftsverwaltungsrecht*, Band (Volume) 1, 2nd ed., 1953, pp. 565 *et seq.*

785 For further details, see the decision of the Constitutional Court of Rhineland-Palatinate (RhPfVerfGH), (2000) DVBl. 992; M Burgi, *Kommunalrecht*, 2006, pp. 52, 250; contra G

On the other hand, as regards the lack of guarantee of the continuance of existing municipal undertakings, Article 28(2) GG does have the same effect as fundamental rights such as Articles 12 and 14 GG (on which municipalities or public undertakings are generally not able to rely), in that such rights serve as defence rights (*Abwehrrechte*) against state restrictions.[786]

However, Article 28(2) GG only allows municipalities to settle their local affairs within 'the limits of law'. Thus, the *Bund* and the *Länder* enjoy a wide margin of appreciation when regulating the boundaries of such affairs, as long as the traditional institution (i.e. the core or *Kernbereich*) of municipal self-government is left intact.[787] Interferences by the *Bund* or the *Länder* which do not remove from the municipalities all of their original competences, are only reviewed by the courts to the extent that they are in the general interest, reasonable and meet the proportionality test.[788]

Püttner, 'Der verfassungsrechtliche Rahmen für die Energieversorgung in Deutschland', (1991) Landes- und Kommunalverwaltung (LKV) 209; J Hellermann, J Wieland, *Der Schutz des Selbstverwaltungsrechts der Kommunen gegenüber Einschränkungen ihrer wirtschaftlichen Betätigung im nationalen und europäischen Recht*, Köln, 1995, pp. 102 *et seq.* Municipal supply activities are normally subject to the EC competition rules because they are either public undertakings or undertakings, which are furnished with special or exclusive rights. Article 86(1) EC might also apply to the cross-subsidies between energy supply and other public services of municipalities (*Querverbund*) mentioned *supra*, see nn. 685, 780 and accompanying text. According to the ECJ, subsidies may only be outside the scope of the EC state aid rules of Article 87(1) EC if they are necessary in order to warrant the continuation of services of general economic interest. Thus, in particular German municipalities and their energy supply undertakings seek a more generous application of Article 86(2) EC in conjunction with Article 16 EC to the services of general economic interest they pursue. More generally on public undertakings, see *infra* chapter 7 on the European Union.

786 The economic operations of municipalities are part of the guarantee of their right to accomplish communal tasks under their own authority (*eigener Wirkungskreis* – original sphere of activity), see Ruthig/Storr, n. 780, no. 128. Article 28(2) GG, which is only an objective institutional guarantee (not a fundamental right) and which serves as a structuring principle of public administration. However this only protects the municipalities against the transfer of tasks to state institutions higher in hierarchy, not against the privatization of communal tasks, see Ruthig/Storr, n. 780, no. 461. But see also section IV *infra* as regards the question whether municipalities (or, more generally, public undertakings) are exceptionally allowed to invoke fundamental rights.

787 Article 28(2) GG also guarantees that municipalities are furnished with a minimum level of financial means as a prerequisite for the independent execution of their tasks, and thus also such tasks which fall within their own responsibility. This does however not give them the right to a specific source of income. Papier in Maunz/Dürig, *Grundgesetz – Kommentar*, Article 14 no. 342. The State is not allowed, however, to direct the use of the financial means available to municipalities too excessively so that their independent responsibility is indirectly undermined, see in greater detail, Scholz in Maunz/Dürig, *ibid*., Article 28 no. 84c. The State is only allowed to deprive municipalities of administrative tasks with a local character for general interest reasons, i.e. if either such tasks are not (or cannot anymore be) executed in an orderly fasion or the reasons for deprivation outweigh the constitutional principle of the distribution of competences set out in Article 28(2) 1st sentence GG.

788 See BVerfGE 79, 127 – *Rastede*. The difference to the usual proportionality test applied (when fundamental rights are interfered with) lies in the reduced scope for the court to review the

Although Article 28(2) GG does not protect municipal undertakings from competition in principle, municipalities are allowed, within certain limits, to participate in competition, such as competition for energy supply services. Neither the German Grundgesetz nor European law prescribe the subsidiarity of public to private economic activity. The German Grundgesetz explicitly refers to public undertakings and private undertakings, which have (partly) public shareholders (*gemischt-wirtschaftliche Unternehmen* or *Eigengesellschaften*).[789]

Municipalities and (possible legally independent) wholly owned energy supply "subsidiaries" remain, however, part of the state executive[790] when participating in competitive and economic activities. This means that energy supply related activities of the municipalities, as any other state activity, must be justified by a public objective or the general interest. The actual energy supply activity of municipalities does comply with such objectives on the basis of the residual responsibility to guarantee the provision of such services. On the other hand activities which are exclusively pursued for reasons of profit maximization can never be legitimate economic activities of municipalities.[791]

Further, the institutional guarantee of Article 28 (2) GG is limited to local matters and the local community, a category which energy supply is generally perceived to fall within, at least when concerned with the distribution and supply of electricity and gas. Since this task is not exclusively conferred upon municipalities, it is thus not an exclusive matter of the local community. The Federal Administrative Court (*Bundesverwaltungsgericht*) by appreciating that the decision to perform energy supply at local level is a matter of the local community, confirmed that energy supply can be performed by private, communal and private undertakings (partly) held by public shareholders such as municipalities.[792]

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necessity (second leg of the proportionality test) of legislative measures, which affect the whole range of communal tasks by, for example, restraining the extent to which municipalities can carry out their tasks on their own authority. Restrictions on municipal activities in the energy sector may also be imposed by *Länder* legislation on local government (*Gemeindeordnungen*). As liberalization of the sector progresses, however, some *Länder* have exempted municipal undertakings from such restrictions in order to guarantee unhindered and equal market access. It is disputed whether these exemptions are admissible against the background of the constitutional principle of local self-government as set out in Article 28(2) GG (see nn. 783, 797) and given that the fundamental rights of private competitors also need to be considered, see in greater detail, Pielow, n. 760, no. 51, with further references.

789 See in more detail as regards the different legal forms of municipal economic operations, Ruthig/Storr, n. 780.

790 *Cf.* Articles 1(3), 20(3) GG. See also Pielow, n. 760. See, however, section IV (1) (d) (bb) *infra*.

791 See also Pielow, n. 760.

792 Municipalities are not prevented from privatizing or selling their (vertically integrated) energy undertakings provided that they ensure that their supply obligations are honoured (*Privatisierungsfolgenverantwortung*). This responsibility means that municipalities must secure adequate performance and/or liability clauses in the privatization contract, see Ehlers,

Accordingly, the legislator is not able to deprive the municipalities of their task to supply energy locally and shift it, for instance, to the districts (*Kreise*), the German states (*Länder*) or onto the federal level (*Bund*).[793]

The guarantee of (autonomous local) self-government does not contravene energy market liberalization in the EU because EC law treats public or municipal undertakings as equal to private undertakings pursuing an economic activity.[794] Such public/municipal undertakings are also covered by the EC fundamental freedoms.[795] German municipalities are increasingly perceived as normal market participants and competitors for services, roles which are not exclusively and explicitly conferred upon them by law.[796]

This development is also reflected by the introduction of the concept of the obligation to provide basic energy supply (*Grundversorgungspflicht*) according to section 36 EnWG, which, however, is likely to keep the municipality-wide energy supply in the hands of the municipalities (and their *Stadtwerke*) for the time being. However, this is now open to competition since section 36(2) 1st sentence EnWG stipulates that such an ESU will be nominated as a basic supplier which "supplies most of the household customers within a network area of general

n. 697, p. 127. Normally, it can be assumed that private energy supply either in the form of operating the distribution networks or supplying energy as a *Grundversorger* according to s. 36 EnWG does not raise any concerns in this regard. As to the constitutional and public law concerns as regards the communal economic activity in the form of private law undertakings, see Pielow, n. 760, nos 68 *et seq.* As regards the requirement limiting the financial risk municipalities are taking when choosing private law legal personality, see Pielow, n. 760, no. 73.

793 *Supra*-communal engagement in energy supply, i.e. exceeding the local level and comprising of several municipalities or even a whole region, on the other hand, is possible by way of consensual cooperation, in particular in order to take advantage of economies of scale in the form of communal joint ventures such as, for instance, is the case for EnBW.

794 See further Part 2 Chapter 7 on the European Union. With respect to the relationship between municipalities and their private competitors, two issues deserve mention here: one issue, which has the potential to distort competition between communal and private energy suppliers, is the possibility of municipalities requiring their inhabitants to connect to and use district heating (*Fernwärme*). This does not only interfere with the rights of owners of heating installations because they cannot use them any longer, but it also excludes actual or potential competitors. The latter consequence might be seen as an interference with fundamental rights of private competitors, in particular Article 12 GG, which protects economic operations. Another issue is the virtual incapability of becoming insolvent (and thus ranking higher in creditworthiness), which again is a distortion of competition.

795 On the other hand, municipal undertakings are not supposed to enjoy the same level of protection as compared to their private competitors, see in more detail, Pielow, n. 760, no. 83, and the reference in Article 3(1) Energy Directives 2003 to non-discrimination conditional upon institutional organization (of the Member States).

796 *Cf.* J Kühling, 'Verfassungs- und kommunalrechtliche Probleme grenzüberschreitender Wirtschaftsbetätigung der Gemeinden', (2001) NJW 177, 182.

supply." This does not, however, interfere with Article 28 subs. 2 GG because this provision, apart from being a continuation of the historic neutrality of German energy industry law as regards to who can perform energy supply, reflects an economic decision of the legislature of an allocative nature as regards the responsibility for energy supply at local level, which follows the deliberations of the *Bundesverwaltungsgericht* (see above) which concluded that the execution of energy supply has historically always been performed by a mix of private, communal and private undertakings (partly) held by public shareholders such as municipalities. From a more practical point of view, the introduction of the basic supply obligation should not meet much resistance by municipalities because it merely reflects the separation of the network operation from energy supply on the one hand, and the introduction of competition in energy supply on the other. With the introduction of this concept, the municipalities are released from their basic responsibility for municipal energy supply, which, with growing competition, could have increasingly turned into an economic burden such a basic supply obligation usually entails.

Recent developments both in European and German energy law have exerted substantial pressure on municipalities to adjust the way they supply services, for example by cooperating with other municipalities (public public partnerships such as one of the two major shareholders of EnBW*)*, or jointly with private undertakings (public private partnerships).[797] Also, the trend towards more decentralised energy supply by using RES, CHP and district heating, and the emphasis on the efficient use of energy appear to play into the hands of German municipalities.[798] These opportunities are even greater because of the municipalities' influence on the location of power plants, storage facilities and energy networks in the course of city and regional planning.

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797 They also become increasingly commercially active outside their territories and even abroad (see only RWE). It should be noted though, that the constitutional guarantee of Article 28(2) GG (see n. 783) defines economic activities of municipalities, see Tettinger in von Mangoldt/Klein/Starck, *Bonner Grundgesetz*, Band 2, 5th ed., 2005, Article 28, nos 170, 173, with further references; K Stern, *Das Staatsrecht der Bundesrepublik Deutschland*, Band 1, 2nd ed., 1984, p. 412; E Schmidt-Aßmann, 'Kommunalrecht', in E Schmidt-Aßmann (ed.), *Besonderes Verwaltungsrecht*, 13th ed., 2005, ch. 1, no. 120. Accordingly, any economic activity municipalities seek to carry out (e.g. offering energy-related services outside their territories) must have a specific link to matters of the local community. Mere economies of scale are not sufficient, see B Uhlenhut*, Wirtschaftliche Betätigung der Gemeinden außerhalb ihres Gebiets*, 2004, p. 96, with further references. Moreover, a municipality must respect the right of self-government of other municipalities, Uhlenhut, *ibid*., p. 203. Consequently, cooperations between municipalities are possible, see the example of EnBW. Contra H Jarass, 'Aktivitäten kommunaler Unternehmen außerhalb des Gemeindegebiets', (2006) DVBl. 1; Kühling, n. 796, p. 179.

798 For in-depth analysis, see Pielow, n. 760.

3. FEDERAL CONSTITUTIONAL COURT

In order to develop an understanding of the controversy, which the intention to introduce further unbundling measures in the energy supply sector has caused in Germany in particular, it is necessary to shed some light on the constitutional roles of the BVerfG and the European Convention on Human Rights, and on the position the Court is taking with respect to the relationship between EC law and the GG.

Article 20(3) GG, one of the core provisions of the German Grundgesetz provides that the legislature is subject to the constitutional order of the Federal Republic of Germany, and the executive and judiciary (apart obviously from also being subject to the constitutional order) to law and justice. Article 20(3) GG is reinforced by a constitutional judiciary (*Verfassungsgerichtsbarkeit*) with the Federal Constitutional Court as the highest court in Germany.

The *Bundesverfassungsgericht* is an independent constitutional institution of the Federation, and as such, it can force all other institutions and constitutional powers to obey the constitution. It can thus also be characterized as *the* guardian of the German Constitution, which, amongst other roles, is the final arbiter and interpreter of the constitution. Nevertheless, the German constitution does not render the *Bundesverfassungsgericht* a primus inter pares but creates a coordinated order, in which the BVerfG (and the judiciary in general) ranks on equal footing with the other constitutional powers.[799]

The *Bundesverfassungsgericht* participates in the development of the constitution constructively, i.e. it not only applies and construes the law but by construing it, it also develops it albeit within the limits of the German Grundgesetz.[800] The *Bundesverfassungsgericht*, however, is not allowed to review legislation with respect to its underlying purpose (*Zweckmäßigkeit*) as long as the purpose of legislation stays within the boundaries of the German Grundgesetz. When it declares a provision of law unconstitutional, it must not put its opinion in place of the legislature's view. According to the principle of construing legislation to be in conformity with the Constitution to the fullest extent possible, which the BVerfG has developed itself, if there are several options of interpretation, it must give priority to an interpretation, which renders the legislation compatible with the German Grundgesetz.[801]

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799 Maunz in Maunz/Dürig, n. 790, Article 94 no. 3.
800 Maunz in Maunz/Dürig, n. 790, Article 94 no. 4.
801 Maunz in Maunz/Dürig, n. 790, Article 94 no. 6.

The *Bundesverfassungsgericht* can declare any unconstitutional law, even parliamentary legislation, void (*ex tunc*)[802]; such a declaration has the force of law. Moreover, the so-called reference to the BVerfG by the courts (*Richtervorlage*) according to Article 100(1) GG and the constitutional complaint (*Verfassungsbeschwerde*) according to Article 93(1) no. 4a are an almost absolute guarantee that an unconstitutional law will in fact reach the BVerfG for judicial review.[803]

European Convention on Human Rights

Legislation which infringes international law, and in particular international treaties, is not void or invalid within German boundaries.[804] This does, however, not apply to the general rules of (in particular customary) international law.[805] As

802 Sovereign acts of the executive and the judiciary, which are based upon laws declared void later, remain in force in most cases, see s. 79 BVerfGG (Gesetz über das Bundesverfassungsgericht (Law on the Bundesverfassungsgericht) of 12 March 1951, revised version (*Neufassung*) published on 11 August 1993, BGBl. I, p. 1473). Above all, however, Article 100(1) GG confers a sole right to quash laws (*Verwerfungsmonopol*) on the BVerfG, which means that nobody should rely on a law being void until it has been declared void by the BVerfG. The monopoly on quashing laws according to Article 100(1) GG also means that any court in Germany, which considers a provision of a law unconstitutional must stay the proceedings and refer to the BVerfG for judicial review; only the BVerfG can tell the parliamentary legislator who is directly legitimized by the German people that it has infringed constitutional law, BVerfGE 17, 208, 210.

803 Apart from being the final arbiter in questions of interferences with German fundamental rights, against the background of the constitutional principle that every act of the executive requires an authorization in the law (*Vorbehalt des Gesetzes*). Together with the principle of the priority of the law (*Vorrang des Gesetzes*, i.e. decisions of the legislator bind the administration and take priority over the decision-making powers of the administration), it is the expression of the constitutional principle of the legality of administration (*Gesetzmäßigkeit der Verwaltung*). Highly important in the context given, in order to hold the executive and with it eventually also the legislature accountable more effectively and rendering its acts more transparent (legal certainty), the BVerfG has also developed the theory that all material issues relevant for the enforcement of parliamentary legislation must be provided for in the law (*Wesentlichkeitstheorie*). This principle derives from the authorization of the executive by parliamentary law according to Article 80(1) 2nd sentence GG to set secondary legislation (or statutory law or regulations) (*Rechtsverordnungen*). Such an authorization is only constitutional if it provides for content and substance, aim and extent of such secondary legislation. The *Wesentlichkeitstheorie* requires the legislature to resolve all essential aspects of the subject-matter to be regulated itself, i.e. it is not allowed to leave the regulation of a subject-matter to the executive. The legislature should at no time be allowed to shift its responsibility to the executive. The jurisprudence on the principle on the *Wesentlichkeitstheorie* is such that according to its deliberations and content, the principle can and must be applied to all and every thinkable legislative authorization conferred upon executive organs.

804 See BVerfG, 14 October 2004, 2 BvR 1481/04, 14.10.2004; see also Herzog in Maunz/Dürig, n. 790, Article 20 VI no. 20.

805 For the peculiar German definition of this term, see Herdegen in Maunz/Dürig, n. 790, Article 25 nos 19 *et seq.*

part of the federal law such rules have direct effect in Germany. According to Article 25 1st sentence GG, they rank below German constitutional law but above formal federal legislation, over which they take priority.[806]

The ECHR and its protocols are international treaties, which have been incorporated into German law according to Article 59(2) GG. Thus, they do not belong to German constitutional law but have the mere status of a federal law (*Bundesgesetz*), which has to be observed by the courts and applied when interpreting national law. The guarantees of the Convention and its protocols do thus not supersede the provisions of the GG. The Convention and its jurisprudence do, however, serve as a tool or aid for the interpretation and the determination of content and reach of German fundamental rights and the principles of the rule of law as set out in the GG, at least insofar as they do restrict or reduce the fundamental rights protection of the GG.[807]

The decisions of the European Court of Human Rights (ECtHR), which the Contracting Parties to the Convention have agreed to adhere to, are, nevertheless of particular importance. The binding character of decisions of the ECtHR extends to all state institutions and obliges them within their sphere of competence and without contravening their commitment to law and justice (Article 20(3) GG) to terminate continuing violations of the Convention. It is the task of the BVerfG to prevent and eliminate any violations of international law to the greatest possible extent. This is particularly true for the international law obligations deriving from the ECHR, which contributes to the promotion of the development of fundamental rights in Europe.[808]

The elaborations on the relationship between the GG and the ECHR show that Germany possesses its very own fundamental rights standard (compared to the other two Member States under review here), which the BVerfG has been protecting and developing over the years since the German Grundgesetz entered into force in 1949, particularly in the context of an ever growing integration of

806 Herdegen in Maunz/Dürig, n. 790, Article 25 nos 42–3.

807 N. 804.

808 *Ibid*. According to Article 35 ECHR, the ECtHR deals with a complaint falling under its jurisdiction after all domestic remedies have been exhausted. Jurisdiction according to Article 1 ECHR has to be understood as "primarily territorial", see ECtHR, *Bosphorus Hava Yollari Turizm* v *Ireland*, no. 45036/98 (GC), ECHR 2005-VI, no. 136, thus making it possible to declare applications connected to Community acts admissible *ratio materiae*. When examining Article 1 ECHR, the Court thus focuses on the concrete national decision rather than on its original basis in EC law. If the request of a preliminary ruling of the ECJ according to Article 234 EC had been refused at some stage during domestic proceedings, this needs to be appealed against before the BVerfG first as the ECJ is considered a legally competent judge according to Article 101 GG.

Germany into the European Union. In particular the issue of whether there is sufficient fundamental rights protection at EU level has repeatedly called the BVerfG into action.

4. APPLICABILITY OF GERMAN CONSTITUTIONAL LAW

After much scepticism of the BVerfG in its *Solange I* decision of 1974 as regards the standard of fundamental rights protection in the EU, it changed its view after analysing the development of fundamental rights protection by the ECJ culminating in its famous judgement in *Hauer*[809], certifying that the ECJ had developed a standard of fundamental rights protection equivalent to German fundamental rights protection.[810] The BVerfG declared constitutional complaints against acts of the Community for violating fundamental rights inadmissible as long as (*Solange*) the level of protection of fundamental rights by the ECJ achieved so far does not fall short of the level required by the German Grundgesetz as indispensable.[811]

In this so-called *Solange II* decision of 1986, the BVerfG clarified that Article 24(1) GG is the constitutional basis, which enables Treaties to transfer sovereign powers to *supra*-national institutions and the law passed by such institutions to take priority over national law in terms of validity and applicability, based on a corresponding national order of applicability (*Rechtsanwendungsbefehl*). The order of applicability contained in the Act approving the EEC Treaty (and hence Germany's accession to the EEC) provides for the direct validity of Community Regulations for the Federal Republic of Germany and its applicability in priority to national law.[812]

As a consequence, the BVerfG initially rejected the admissibility of constitutional complaints against acts of the Community. It took the view that Regulations of

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809 N. 536.

810 This analysis has been undertaken rather superficially to date: although the Court in its *Solange II* decision, BVerfGE 73, 339, listed comprehensively the developments in fundamental rights protection, it did not go into detail in particular as regards the depth and breadth of fundamental rights protection (*Kontrolldichte*) and did not review whether there has ever been an effective protection; see in this respect also M Cornils, 'Article 23 Abs. 1 GG: Abwägungsposten oder Kollisionsregel?', (2004) Archiv des öffentlichen Rechts (AöR) 336, 375, with further references. In BVerfGE 102, 147, 162 – *Bananenmarktordnung*, the BVerfG avoids any new discussion of the question of compatibility of the two fundamental rights standards.

811 BVerfGE 73, 339, 378 *et seq*., 387 – *Solange II*.

812 *Ibid*., 375. This is obviously in contradiction to the supremacy claim of the ECJ but can be observed in most of the constitutional laws of the Member States, see Cornils, n. 810.

the Community (according to Article 189(2) EEC, now Article 249(2) EC) are not acts of German public authorities.[813] In its Maastricht decision[814], however, the BVerfG reversed its approach in that it emphasized its task to generally safeguard the effective protection of fundamental rights for the inhabitants of Germany, including safeguarding them against the sovereignty of the European Communities: "Acts of a special public authority of a *supra*-national organization separate from the public authorities of the Member States also affect fundamental rights beneficiaries in Germany. They thus affect the guarantees of the German Grundgesetz and the tasks of the Federal Constitutional Court, which are concerned with fundamental rights protection in Germany and in this respect [are safeguards] not only against German state authorities […]."[815]

This can be seen as a confirmation of the changed view of the BVerfG that European law is part of a uniform legal order applicable in Germany. Such applicability derives from and is based upon the German Act sanctioning the EC Treaty (*Zustimmungsgesetz*), which is the authority for applicability of the foreign law, to which the GG opens itself via Article 23(1) GG.[816]

This new view has basically not changed as of today. Thus, the law of the EU as derived law is indirectly also subject to the control of the Federal Constitutional Court.[817] Since the *Maastricht* decision of 1993, the relationship of the national constitutional courts to the European courts has been problematic in two respects. It is still not resolved who actually has the last say as regards effective fundamental rights protection in the European Union. A further conflict is about who is competent to check compliance with the principle of conferred powers in Article 5(1) EC, or in other words, the distribution of competences between the Member States and the EC and its observance by the European institutions (so-called *Kompetenz-Kompetenz*).

As regards the protection of fundamental rights, in its 1993 *Maastricht* decision on the ratification of the Maastricht Treaty, the BVerfG assumes a relationship of cooperation ("Kooperationsverhältnis") with the ECJ.[818] With respect to

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813 BVerfGE 22, 293, 297; 58, 1, 27.

814 BVerfGE 89, 155, 175 – *Maastricht*.

815 *Ibid*.

816 Article 23(1) GG is the successor of Article 24(1) GG and incorporates the *Solange II* case law into the German Constitution. This will not change with the new Treaty of Lisbon. M Herdegen, *Europarecht*, 2006, § 11 nos 5, 22.

817 Moreover, the membership to the European Union can even be annulled by the Member States as "Masters of the Treaties", see n. 814, 190.

818 Which it actually bases on Article 234 EC (references by national courts to the ECJ for preliminary rulings), see BVerfG, 14 May 2007, 1 BvR 2036/05 – *TEHG* (implementation of the EC Emission Trading Directive).

European legal acts, it is for the ECJ to protect fundamental rights. Only if it can be proved that the protection granted by the ECJ generally and evidently falls short of the level of protection, which the GG requires as indispensable, will the BVerfG resume its jurisdiction over the applicability of EC law in Germany.[819] This jurisprudence was confirmed by the BVerfG in its 2000 decision on the *Bananenmarktordnung*.[820] This decision, however, introduced high admissibility hurdles by requiring a strict burden of proof as regards justifying the claim that the level of protection of fundamental rights as demanded by *Solange II* has generally detoriated.[821] Thus, only if it is substantiated that the jurisprudence of the ECJ has detoriated below a level of fundamental rights protection comparable to the fundamental rights protection of the German Grundgesetz in a range of decisions or in a grave individual case will the BVerfG assume jurisdiction.[822] The requirement of sufficient substantiation has so far not been fulfilled in any proceedings.[823]

However, with the prospect of the introduction of ownership unbundling or independent system operation, this might change for the first time. Should the proposals for Energy Directives enter into force as they are, the ECJ might consider the prescriptions for ownership unbundling and/or "deep" ISOs compatible with European fundamental rights. Should, however, the BVerfG (if called upon) come to the conclusion that the protection of fundamental rights has fallen below a level comparable to the protection of German fundamental rights, notably as regards the protection of the right to property, then the question might be asked whether this indeed is such a grave individual case.

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819 *Ibid*.

820 BVerfGE 102, 147, 161 *et seq*., 164 – *Bananenmarktordnung*; see also Herdegen; n. 816, § 11 no. 28; K Hailbronner, G Jochum, *Europarecht – Teil 1*, 2005, no. 588; R Streinz, *Europarecht*, 5th ed., 2001, no. 217. Confirmed by the BVerfG, BVerfGE, 111, 10: "Community law is not measured by the Federal Constitutional Court at the fundamental rights standard of the *Grundgesetz*. Constitutional complaints and references by courts, which invoke a violation of fundamental rights of the *Grundgesetz* by secondary Community law, are *per se* inadmissible if their substantiation does not show that the development of European law including the jurisprudence of the European Court of Justice has slumped below the indispensable protection of fundamental rights of the *Grundgesetz*."

821 Or, it is submitted, has actually never existed taken the superficial assessment of fundamental rights protection in *Solange II*, see 810. Such proof can in principle be introduced in any court in Germany which is even incidentally concerned with a possible review of European legislation, for instance, when assessing the legitimacy of German legislation implementing a European Directive; see in this regard, BVerwG, 30 June 2005, 7 C 26.04 – *TEHG*, p. 18.

822 See, for instance, Herdegen; n. 816, § 11 no. 32.

823 See, e.g., BVerfG in re *Bananenmarktordnung*, n. 810, and BVerfG, 31 March 1998, 2 BvR 1877/97 and 50/98.

In any event, this reservation continues to exist and contrasts with the unrestricted primacy of EC law advocated by the ECJ.[824] This was confirmed by

824 ECJ, C-6/64 – *Costa v ENEL*, (1964) ECR 585, C-106/77, *Simmenthal* v *Administrazione delle Finanze*, (1978) ECR I-629, no. 21 *et seq.* This is the expression of a monist or monistic legal order as described in chapter 6 on the Netherlands. The ECtHR also seems not to recognize the primacy of the EC fundamental rights protection with the European Union as a reservation similar to the BVerfG's was expressed by the ECtHR (with respect to EC law) in re *Bosphorus*, n. 808. In March 1997, Bosphorus complained to the ECtHR that Ireland violated his right to property according to Article 1 of the First Protocol to the ECHR when fulfilling the obligations of its EU membership. The ECtHR inter alia examined whether the presumption applies that Ireland complied with its commitments under the ECHR in fulfilling the obligations of its EU membership in the case at hand, and whether any such presumption has been rebutted. The ECtHR took the stance that such a presumption can indeed be rebutted if it was found in a particular case that the protection of the Convention rights was manifestly deficient; Judge Ress warned in his concurring opinion that the concept of presumption of Convention compliance should not be interpreted as excluding a case by case review by the ECtHR of potential Convention violations. In such cases, the interest of international cooperation would be outweighed by the Convention's role as a "constitutional instrument of European public order" in the field of human rights, see *Bosphorus*, n. 808, no. 156. The Court continued that having examined the legal regime for the protection of fundamental rights in the EU, this protection can and could at the relevant time be considered to be "equivalent" to that of the Convention, see *Bosphorus*, n. 808, nos 161–165. The Court did make it clear that it is prepared to examine the specific circumstances of future cases in order to effectively review potential shortcomings in the protection of fundamental rights on the Community level. This might, however, mean that the ECtHR will not involve itself in fully reviewing Community legislation but rather review the Community system of fundamental rights protection more generally and abstractly, see K Kuhnert, 'Bosphorus – Double standards in European human rights protection?', (2006) Utrecht Law Review 177, 185, which might also be what the German BVerfG expressed with its *Solange II* doctrine (see n. 810). Consequently, the presumption was upheld that Ireland did not depart from its obligations under ECHR when it honoured its obligations under its EU membership. The Court also held that the protection of Bosphorus' Convention rights was not manifestly deficient and, thus, the presumption of compliance with the ECHR by Ireland had not been rebutted. The application and implementation of primary and secondary Community law respectively by the Member States is subject to review by the ECtHR because they originally participated in the legislative process and are considered the original legislators of Community legislation responsible for any shortcomings in this respect. In *Cantoni* v *France*, no. 17862/91 (GC), ECHR 1996-V, the ECtHR enabled an applicant to challenge a national act based on EC law before the ECtHR after having exhausted all other remedies available. Following this case, the ECtHR was able to examine whether the national act originating in EC law amounted to a violation of the ECHR and whether the ECJ provides equivalent protection of the applicant's fundamental rights. The review of the compatibility of primary EC law with the ECHR became possible in *Matthews* v *UK*, no. 24833/94 (GC), ECHR 1999-I, because the EC Treaties are the result of the Member States own legislation of approval. The direct review of EC legislation should become possible at the latest when the EU accedes to the ECHR, which the Treaty of Lisbon, see n. 368 in Part 1 Chapter 3, provides for once it has entered into force. Consequently, the Court assumes the competence to review primary and secondary EC law indirectly through examining (implementation) measures of the Member States based on primary and secondary EC law respectively. With the "manifest deficiency" approach, the ECtHR has afforded itself considerable discretion emphasizing its view of being the final arbiter of fundamental rights protection in Europe. In this respect, see also Kuhnert, *ibid*., 188. The ECtHR decision in re *Bosphorus* bears some resemblance to the *Solange II* doctrine of the BVerfG (see n. 810), see also F Schorkopf, 'The European Court of

the BVerfG in its 2004 *Görgülü* decision, in which albeit that it was concerned with the relationship to the ECHR it incidentally refers, with respect to the European Union, to a "reservation of sovereignty (*cf.* Article 23(1) GG), which has indeed far receded".[825] According to this decision, international law deriving from Treaties is only applicable in Germany if incorporated in the national legal order both correctly in form and in accordance with substantial constitutional law.[826] This continues to be the case even after its 2005 decision on the *European Arrest Warrant*[827] where the BVerfG declared the implementing law of the framework decision on the European Arrest Warrant void. The legislator had not sufficiently used the existing implementation options in particular with regard to crimes with strong national bonds, as required by the GG for the protection of German nationals.[828] As the framework decision had offered such options, the BVerfG was able to base its decision on its own case law. According to this case law, the choice made by the German legislature as a consequence of EC law granting the Member States some discretion with respect to national implementing measures, is always fully verifiable.[829] This last statement was confirmed by the BVerfG in re *Mischfuttermittel*[830] and, which is closer to the context given here, in *TEHG*.[831]

According to the *Mischfuttermittel* decision, the observance of the EC fundamental rights standard depends on the degree to which the provisions of an EC Directive are mandatory. Only in the case of an exact implementation where national law exactly replicates what has been mandated by the Directive, can the implementing Act be measured against the EC fundamental rights standard alone. If there is, however, a certain range of interpretations possible under the Directive, which confers upon the national legislator some leeway with respect to the interpretation and structure of the Directive's provisions to be implemented, the national legislature acts under its national authority and, thus the resulting law is to this degree to be evaluated according to German fundamental rights.

Human Rights' Judgment in the Case of *Bosphorus Hava Yollari Turizm v. Ireland*', (2005) German Law Journal 1255, 1264.

825 BVerfGE 111, 307, 319.

826 See *ibid.* This is the expression of a dualist or dualistic legal system as in place in Germany and the UK.

827 BVerfGE 113, 273 – *Europäischer Haftbefehl.*

828 *Ibid.*, 292 *et seq.*, 302.

829 BVerfG, 9 January 2001, 1 BvR 1036/99. See also J Komárek, 'European Constitutionalism and the European Arrest Warrant – in search of the limits of the "contrapunctual principles"', (2007) CML Rev. 9.

830 See n. 820.

831 See n. 818.

In its *TEHG* ruling, the BVerfG confirmed the decision of the Federal Administrative Court (*Bundesverwaltungsgericht* – BVerwG), which measured the essential principles of the implementing law (which followed the Directive's essential principles) against the standard of the community fundamental right to property, and the specific provisions based thereon against the fundamental rights standard of the GG. The BVerfG, however, stressed again, in another more recent decision on the TEHG[832], that the national implementation of binding provisions of a Directive, i.e. those provisions not leaving any discretion to the Member States, are not measured against standard of the GG as long as they fulfil the *Solange II* doctrine.

As the case *European Arrest Warrant* shows, the BVerfG restrains itself by means of its own "cooperation" doctrine even if it explicitly leaves open its option to check the conformity of the Framework Decision (taken by the European Union), on which German implementing legislation is based, with the GG.[833] Consequently, this decision can be taken as a good example of the willingness of the BVerfG even in the area of the EU's third pillar law, to grant legal protection in cooperation with the ECJ and in line with its *Maastricht* decision according to which the reserve competence (to enforce fundamental rights protection) will only be exercised in exceptional circumstances.[834] This is also reflected in its *Teilzeit* decision of January 2001[835], where the BVerfG clarified that in the case of an alleged violation of fundamental rights, the correct route of action for effective fundamental rights protection against European legal acts is the reference by national courts to the ECJ according to Article 234 EC.[836] On the other hand, the BVerfG does indeed recognize deficiencies in the comprehensive review of the proportionality principle by the ECJ when measuring such a review against the level or depth of review (*Kontrolldichte*) according to German constitutional law. According to the BVerfG, this deficiency was however remedied by the BVerwG in its *TEHG* ruling[837] as "part of the dialogue of the courts throughout the

832 13 March 2007, 1 BvF 1/05.

833 Which it might have done if, for instance, the Framework Decision had not offered alternatives acceptable under the German standard of fundamental rights protection. This would have actually meant that the implementing law was to be treated as a word for word translation of European legislation into German law as if there was no scope for interpretation.

834 See I Pernice, *Das Verhältnis europäischer zu nationalen Gerichten im europäischen Verfassungsverbund*, 2006.

835 See n. 829.

836 Confirmed by the BVerfG, n. 832. It is still not clear whether the BVerfG must make a reference to the ECJ according to Article 234 EC before it quashes secondary Community law because of deficient fundamental rights protection or for a lack of competence. In this context, it seems appropriate for the BVerfG to actually have to make such a reference because only after obtaining the ECJ's view is it credible for the BVerfG to evaluate whether the German standard of fundamental rights protection is maintained or a competence complied with.

837 See n. 821.

Community"[838] by applying the European interpretation of the proportionality test with a German standard of review with respect to the proportionality of the EC Emission Trading Directive. It is submitted though that had the BVerwG come to a negative conclusion as regards the proportionality of the Emission Trading Directive, it would have had to make a reference to the ECJ for a preliminary ruling according to Article 234 EC. Had the ECJ declared the Directive proportionate according to its own "shallow" proportionality test[839], this would then have seriously tested the *Solange II* doctrine as developed by the BVerfG for the first time.

Coming back to the *Maastricht* decision, European legal acts without a corresponding competence or exceeding an existing competence, i.e. legal acts "ultra vires", are not applicable in Germany. The BVerfG explains that if European institutions applied or developed the EU Treaty in a manner, which is not envisaged by the Treaty as reflected in the German Act approving it (*Zustimmungsgesetz*) and, consequently, not by the authorization of Article 23(1) GG for Germany to participate in the European integration process[840], then legal acts resulting therefrom would not be valid within the area of German sovereignty.[841] German public authorities would be prevented for constitutional reasons from applying such acts in Germany. Accordingly, the BVerfG checks whether legal acts of European institutions stay within the boundaries of the sovereign powers conferred upon them or whether they exceed them.[842]

The BVerfG has as yet not developed any limitations to its control competence similar to the self-imposed one in the area of fundamental rights protection. As can be inferred from the *Alcan*[843] and *Tanja Kreil*[844] cases where the BVerfG checked whether the ECJ acted *ultra vires*, in the latter case coupled with checking whether the application of European legislation was *ultra vires*, the control competence in this respect is not just a reserve competence. The BVerfG sees itself competent as a matter of principle and without referring to a cooperation relationship with the ECJ as it does in the area of fundamental rights protection.[845]

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838 See n. 818.

839 See Part 2 Chapter 7 on the European Union.

840 See Hailbronner/Jochum, n. 820, no. 587; possible decisions of incompatability by the BVerfG would lead to the corresponding European legal act not having any legal effects within Germany, see Herdegen; n. 816, § 11 no. 26.

841 See BVerfGE 89, 155, 175; see also Herdegen; n. 816, § 11 no. 29; Hailbronner/Jochum, n. 820, no. 587; different R Streinz, *Europarecht*, 5th ed., 2001, nos 214, 214a.

842 BVerfGE 89, 155, 188.

843 BVerfG, 17 Feburary 2000, 2 BvR 1210/98.

844 ECJ, C-285/ 98 – *Kreil* v *Germany*, (2000) ECR I-69; C-186/01 – *Dory* v *Germany*, (2003) ECR I-2479;.

845 See Pernice, n. 834.

It can thus be said that the German Federal Constitutional Court reserves a control competence in the area of fundamental rights protection as well as regards an overstepping of the competences conferred upon the European Union (also called "Kompetenz-Kompetenz").[846] This competence can also be seen as a reservation of sovereignty, which is certainly not an extensive one but is solely meant as a last resort. In the area of fundamental rights protection, the control only takes place, if at all, within a "relationship of cooperation"; a clear determination of when legal acts are "breaking free" acts (*ausbrechende Rechtsakte*) or "ultra vires" remains an open issue for the time being.

Applying what has just been set out in general terms to the unbundling requirements of the 2003 Energy Directives but also to future EC Directives requiring further unbundling measures, an exact national implementation has not and most probably will not be required.[847] As regards a future EC Directive, further unbundling requirements will inevitably affect the ownership rights of the respective national energy supply industries. As the ownership structure and network composition of the energy supply industries in the Member States is rather diverse, a "one size fits all" Directive is unlikely to enter into force. This is further emphasized by Article 295 EC, which allows for different systems of ownership rights.[848] In order to achieve an EU-wide minimum standard of energy supply network ownership, the different national systems would have to adjust different components of the property ownership structure of their networks and industry structure.[849]

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846 The latter control competence might, for instance, also become relevant if the European legislature albeit furnished with a competence is not allowed to use it, as might be the case if when legislating for ownership unbundling of energy networks based on Article 95 EC, Article 295 EC is not sufficiently observed.

847 According to Cameron, n. 427, pp. 8, 19, the current EC Energy Directives leave sufficient scope for diversity in the national implementation procedures "in proper appreciation of the wide diversity in their resource base, legal tradition, industry structure, policy choices […]." See also albeit more critically, Hancher, n. 118. The unbundling provisions of the current set of EC Energy Directives lack the precision (*Bestimmtheit*) required to allow the German implementing law, the EnWG, to be measured against the EC fundamental rights standard. One example is s. 8(1) and (4) no. 1, 2nd example EnWG, which exceeds the requirements of Articles 10(2)(a) and 15(2)(a) Electricity Directive 2003, and Articles 9(2)(a) and 13(2)(a) Gas Directive 2003 by not only forbidding the same management from being responsible both for the network business and for any other undertaking of the vertically integrated energy supply undertaking but also from personnel having the final say in decisions essential for the non-discriminatory operation of the networks. Another example is the allocation of network ownership in the course of legally unbundling the network operations within the vertically integrated energy supply undertaking, which leaves it to the Member States to decide whether they want to see the network ownership located at holding level or in the network operation subsidiary.

848 See already Part 1 Chapter 3.

849 Thus, one and the same Directive directed to all Member States is unlikely to be capable of mandating a word for word implementation. In the unlikely case that this nevertheless

As an act of the European Union legislature, the fundamental decision to impose independent network operation upon the European energy markets would have to be measured against European law and fundamental rights as protected by the ECJ.[850] Any measures prescribed in a Directive and implementing this basic decision into national law, however, are to be measured at the GG if they, which is very likely, leave the Member States a choice between, for example, different ways of guaranteeing independent network operations (such as is the case of the draft Energy Directives), which leaves the German Parliament the opportunity to implement an option which is still compatible with the German Grundgesetz.[851]

IV. FUNDAMENTAL RIGHTS ISSUES ARISING IN CONTEXT OF FURTHER UNBUNDLING LEGISLATION

As has been explained above, German legislation introducing further unbundling measures (either unilaterally or based on EC legislation) would have to comply with the fundamental rights standard of the German Grundgesetz, which is outlined in this section IV.

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happens, or in the case where an EC Regulation is introduced, the assumption that EC law is applicable in the event of review is based upon the further assumption that the Community fundamental rights standard is generally equivalent to the German standard (see the BVerfG in re *Solange II*, n. 810).

850 See further in Part 2 Chapter 7 on the European Union.

851 One way of ensuring that such an option is accounted for in EU legislation is by German government representatives taking influence in the Council of Ministers and voting accordingly. In this regard, see, for instance, BVerfG, 12 May 1989, 2 BvQ 3/89, 22 December 1992, 2 BvR 557/88, M Heintzen, 'Zur Frage der Grundrechtsbindung der deutschen Mitglieder des EG-Ministerrats', (1992) Der Staat 367, and Cornils, n. 810. In re *Europäischer Haftbefehl*, n. 827, the BVerfG states (translation by the author): "The legislature was obliged to apply the implementation options, which the Framework Decision gives the Member States, with utmost respect of (German) fundamental rights. […] The legislator could have chosen for an implementation showing this utmost respect for (German) fundamental rights without infringing the binding goals of the framework decision because the framework decision contains exceptions, which give Germany the opportunity to account for the fundamental rights requirements flowing from Article 16(2) GG. […] The exhaustion of the option given by the framework law in the course of implementing it into national law would have avoided a violation by the Law on the European Arrest Warrant (*Europäischen Haftbefehlsgesetz*) of the fundamental right to protection against extradition and the principles of the rule of law, which are applicable in this regard.".

1. RIGHT TO PROPERTY, ARTICLE 14 GG

The evaluation of full ownership unbundling, including by way of share split, and by the Independent System Operator model as proposed by the European Commission[852] in the context of fundamental rights as applied in Germany touches upon the right to property, the freedom of occupation and of economic activity (Article 12(1) GG) and the freedom of association (Article 9(1) GG). The most obvious fundamental right is discussed here first, which is the right to property[853], more specifically the right to own energy networks.

a. Subject-matter of protection

The guarantee of the right to property according to Article 14 GG is to "safeguard proprietary freedom, which makes an independent, self-determined way of life possible."[854] Thus, this guarantee is closely related to *personal* freedom[855] and of essential importance for economic activity (*wirtschaftliche Betätigungsfreiheit*).[856] Apart from its function of safeguarding proprietary freedom, this guarantee also ensures legal certainty in that it protects the confidence of the beneficiary of this fundamental right (*Grundrechtsträger*) that such right continues to exist.[857] All proprietary rights granted by law are protected including share ownership (as opposed to asset ownership).[858] Further, besides the mere possession of property, the protection of Article 14 GG also includes the free use of property and the ability to dispose of it[859], including the free decision to allow third parties to use

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852 These further unbundling measures have been explained in the Introduction.

853 Article 14 GG reads as follows (translation by the author):
"(1) The right to property and the right of succession are guaranteed. Their substance and limitations shall be determined by law.
(2) Ownership obliges. Its use shall also serve the general interest.
(3) Expropriation is only admissible in the general interest. It may only be enforced if so ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation is to be determined by way of establishing a fair balance between the general interest and the interests of the parties involved. […]."

854 See BVerfGE 79, 292, 303; 83, 201, 208; 97, 350, 371; 102, 1, 15.

855 BVerfGE 24, 367, 389; 53, 257, 290; 100, 226, 241; 102, 1, 15, 17.

856 BVerfGE 51, 193, 218; 78, 58, 73; 101, 54, 75; 102, 1, 18; BVerwGE 81, 329, 341.

857 Wendt in Sachs, *GG – Kommentar*, 3rd ed., 2003, Article 14 no. 1.

858 BVerfGE 5, 290 (351); see BVerfG 30 May 2007, 1 BvR 390/04; see also n. 905. See also Papier in Maunz/Dürig, n. 790, Article 14 nos 195–6. There are, however, obvious significant differences between share owners and owners operating the undertaking themselves by assuming personal liability, see BVerfGE 50, 290, 342. Thus, this difference leads to different repercussions for the legislature with respect to the determination of the substance and the limitations of share ownership. In its decision in re *Montan-Mitbestimmung*, the BVerfG, BVerfGE 90, 367, 389, has thus concluded that share ownership enjoys a lesser degree of protection whereas the social obligation (*Sozailbindung*, see n. 104) of share ownership is particularly pronounced.

859 BVerfGE 42, 263, 294; 50, 290, 339; 52, 1, 30 *et seq.*; 88, 366, 377; 101, 54, 75; BVerwGE 92, 322, 327.

the property, in particular for a consideration.[860] As the right to property includes the right of the owner to use the property for his private purposes (*Privatnützigkeit*), it also protects the entrepreneurial freedom to use material and financial assets (*Sach- und Finanzmittel*) in the production process (a freedom, which is also attributed to the freedom of economic activity in Article 12(1) GG) and to organize and structure his business. Through Article 19(3) GG, private legal persons also enjoy protection of their property. Further, the right to own established and active economic operations (*Recht am eingerichteten und ausgeübten Gewerbebetrieb*) is also protected by Article 14 GG.[861]

Finally, at least in the context of further unbundling measures, it is worthwhile to emphasize the right to exercise control as another component of the right to property.[862] In particular the control rights of shareholders over the undertaking they own shares in are worth mentioning and, in this context, their power to determine or at least to give global directions with respect to the way the undertaking operates, also with regard to its property. According to the competition law definition of control, the right to control can be defined as the power to exercise decisive influence on the strategic economic behaviour of the undertaking.[863] The right to control derives from the right to use and the right to dispose and thus partly overlaps with each of them. As a result, the characteristics of the right to property as protected by Article 14 GG comprise of:

- the right to exercise control over the subject matter of property, which is the expression of the positive right to proceed with the property as seen fit (as opposed to the negative right to exclude others from benefiting from one's property);
- the right to use the property in the sense of receiving the profits it produces, for instance, by way of profit distribution; and
- the right to dispose or transfer the property to third parties according to the owner's choice.

860 BVerfGE 98, 17, 35. As regards the entrepreneurial freedom to use tangible and financial means in the process of production and to organize the structure of the undertaking, see Schmidt-Preuß in Baur *et al.* (eds), *Unbundling in der Energiewirtschaft*, n. 539, no. 8.

861 This view is supported by the BGH, BGHZ 23, 157, 162 *et seq.*, and the BVerwG, BVerwGE 62, 224, 226. The BVerfG, in principle, also recognizes the protection of this subject-matter but only to the extent that the legal basis on which the business has been established also enjoys protection, see BVerfGE 58, 300, 353. Consequently, any circumstances not covered by the right to property do not enjoy the protection of Article 14 GG.

862 See already Introduction.

863 For the term 'control', see Introduction.

b. Expropriation and regulation[864]

Having briefly established what the subject-matter of the German fundamental right to property are, it now has to be appreciated that Article 14 GG contains different levels of protection, which have different prerequisites. On an level of principle, ownership can be regulated in Germany by way of determining its substance and limitations (*Inhalts- und Schrankenbestimmung*) and the owner may be expropriated. The boundaries between regulation and expropriation, in particular where compensation payments may become obligatory are, however, rather complicated to draw; compensation (*Ausgleichszahlungen*) to remedy basically disproportionate regulation occurs only exceptionally whereas compensation payments (*Entschädigung*) are required in cases of legitimate expropriations.

Article 14(1) 2nd sentence GG allows for the determination of the substance and the limitations of the right to property. Article 14(3) GG sets out the possibility for expropriation. Article 14(2) GG prescribes that the use of property must *also* serve the general interest (*Wohl der Allgemeinheit*).

The fact that property must also serve the general interest (*Sozialbindung*)[865] is reflected in two provisions of Article 14. According to Article 14(1) 2nd sentence GG, the substance and the limitations of the right to property are determined by law.[866] Article 14(2) GG stipulates that owning property is a privilege and thus must also serve the general interest. Article 14(2) GG is to be understood as a guidance of the legislator to pursue, in the context of the determination of substance and limitations, the aim of making all property rights subject to general interest considerations. Consequently, Article 14(1) 2nd sentence GG and Article 14(2) GG both uniformly subject to parliamentary legislation all determinations made according to the first provision (*Gesetzesvorbehalt*). It is only the legislature which determines the substance and the limitations and thus the degree to which property is made subject to the general interest. The general interest therefore is the reason for and the limitation of the restrictions imposed on the use of property.[867]

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864 In ECHR terminology, both would be a deprivation of the right to property. See in greater detail the chapters to follow.

865 See already n. 104.

866 The term "law" used in Article 14(1) 2nd sentence GG does not only mean formal laws but also laws in a substantive sense, i.e. any valid legal rule, see Papier in Maunz/Dürig, n. 790, Article 14 nos 339 *et seq.*

867 BVerfGE 56, 249, 260; 58, 300, 338; Papier in Maunz/Dürig, n. 790, Article 14 no. 306.

The result of subjecting all determinations to parliamentary legislation (*Gesetzesvorbehalt*) is that only the property as formed by such legislation is protected by the guarantee of ownership. The legislature must establish a system of property ownership, which distinguishes opposing private interests and balances private interests with the demands of the general interest. There is no priority of one over the other interest.[868] Further, the guarantee of the right to property is not only a protection subject to the law but also a protection which directly derives from the constitution to the benefit of the owner, which the legislator must observe. This protection is also in line with other constitutional aims and principles such as the principle of proportionality, the guarantee of equal treatment (*Gleichbehandlungsgebot*) of Article 3(1) GG and the principle of legal certainty (*Vertrauensschutzprinzip*) as a principle of the rule of law.

On the other hand, Article 14(1) 2nd sentence also empowers the legislator to *re*-determine or reorganize the substance and the limitations of ownership. Thus, the legislator can introduce new rights and can terminate existing rights for the future (both to be seen as abstract parts of the right to property, such as the right to use, dispose and to control).

The discretion of the legislator to determine the substance and the limitations of ownership is limited by the guarantee of just balancing (*Gebot gerechter Abwägung*). When making determinations according to Article 14(1) 2nd sentence GG, the legislature must take into account both the constitutionally guaranteed legal (ownership) position and the guarantee of a system of property ownership property ownership which is socially just. The legislature must bring the interests of all parties which deserve protection, into a just balance and a balanced relation to each other.[869] This guarantee of objective legislative balancing[870] and the

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868 If a specific property loses its capability to be used for private purpose(s) (*Privatnützigkeit*) as the result of a legislative intervention, which imposes exclusive use by third parties, the general public or the State, then this is an intervention which is comparable to the deprivation of the right and thus not permissible unless compensation is granted (Papier in Maunz/Dürig, n. 790, Article 14 no. 375). The owner can only use his right in the general interest, the private purpose guaranteed by the constitution has been substituted by the general interest and is thus to be seen as a substantial intrusion into the capability of a specific property to be used for private purposes.

869 Which, it is claimed here, should also involve the analysis of social costs and benefits of introducing such determinations.

870 The objective balancing the legislature has to pursue between safeguarding the guarantee of private property and making property subject to general interest considerations follows the patterns the legislature must observe when interfering in a fundamental right, which is that the legislator has to follow the principle of just balance as regards both the *process of balancing* and the content of the *balancing decision*. This means that the legislative intervention must rely on an almost complete process of balancing, which is based on correct factual assumptions. If the legislature has been influenced by defective assumptions and incomplete considerations,

reconciliation of the guarantee of private property with the social reservations of Article 14(1) 2nd sentence GG and Article 14(2) GG leads, by considering the purpose of protection of Article 14 GG, to a graduated, staged fundamental rights protection: Article 14 GG guarantees private property to ensure individual freedom. On the other hand, the authorization of the legislator to determine substance and limitations is more powerful the more that property is situated in a social context and possesses a social function.[871] Thus, to the extent that property is of importance for the safeguarding of the personal freedom of its owner, it enjoys special protection; the powers of the legislature are therefore much smaller in the case of personal property than, for instance, in the case of the property of companies.[872]

According to Article 14(2) GG, the use of property shall equally serve the general interest. The effects of use of property and its disposal often exceed the sphere of the owner and touch upon the interest of the general public and other legal subjects. The more intensively the use or disposal of property interferes with the third party or general interest, the more substantial such third party interests are and the more the legislator has to take these interests into consideration and the more these third party or general public interests need to weigh in the balancing process. On the other hand, and this is very important, the legislator must always, when determining the substance and the limitations of ownership, obey the general limitation on interventions into fundamental rights as proclaimed in Article 19(2) GG, i.e. the guarantee to safeguard the essential content of a fundamental right (*Wesensgehaltsgarantie*).[873] Thus, any interference with the right to property, i.e. the compulsory transfer of ownership (expropriation) as well as the restriction of its free use, disposal or exploitation (regulation of ownership) are justified only in exceptional circumstances; state measures in particular have to observe the principle of equal treatment or non-discrimination as well as the principle of proportionality with its (strict) requirements of suitability, necessity and adequacy/appropriateness (proportionality in its true meaning).[874] The substance of the guarantee of the right to property marks the

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then the balancing of the various aspects including the evaluation of less intrusive measures during the legislative process is likely not to have been pursued objectively.

871 The guarantee of private property does not protect the use of the property in a way that disregards its social function. The more other parties need to use another's property, the more therefore the subject-matter of the property is subject to its social function, the greater is the scope for implementing limitations for the legislator, BVerfGE 70, 191, 201; 79, 292, 302; 101, 54, 75; 102, 1, 17.

872 BVerfGE 50, 290, 348; see also BVerfGE 58, 81, 112; 79, 283, 289; 100, 126, 241; 102, 1, 17.

873 Papier in Maunz/Dürig, n. 790, Article 14 no. 322.

874 Or, in other words, the legislature, when determining the substance and the limitations of ownership, is prohibited from taking excessive measures (*Übermaßverbot*). When enacting a new law which is not compatible with the legal positions established in the current legal

outer boundary of such interference, which comprises of the principal power to dispose of and the capability to use the property for private purposes (*Privatnützigkeit*) as the basis of private enterprise.[875]

Limitations on the rights of ownership must be based on reasonable objectives in the general interest.[876] This requirement is a consequence of the prohibition of "excessive measures".[877] Accordingly, it is for the legislature to establish political goals. This means that in principle the views of the legislature on the requirement for legislation to avoid any social or economic consequences occurring (i.e. if the legislation in question is not enacted) are decisive. The corresponding wide margins of prognosis for the legislator and limitations on judicial review are the natural consequence if the legislative intervention is suitable according to the principle of proportionality.[878] This is only then not the case if the measure taken is objectively or plainly unsuitable, which is to be judged *ex ante*, i.e. by the facts and their evaluation by the legislature when preparing the law.[879] Only if the legislator has used all means of information available to him, have any

framework, the legislature is normally obliged to facilitate a smooth transition from the current to the new law by providing for transitional measures (*Vertrauensschutzprinzip*). On the proportionality principle, see in greater detail next subsection.

875 BVerfGE 50, 290, 339 – *Mitbestimmung*.

876 In this context, it may be emphasized that a determination of the substance and the limitations of (corporate) property is lawful if the legislature provides for the essential normative conditions for a functioning competition process. The prohibition of cartels, the control of abuses of dominant positions and merger control are thus in principle not objectionable. See Papier in Maunz/Dürig, n. 790, Article 14 no. 506. More generally, U Di Fabio, 'Wettbewerbsprinzip und Verfassung – Der freie Wettbewerb und die Verantwortung des Staates', (2007) ZWeR 266.

877 See n. 874.

878 In its decision concerning the constitutionality of the Co-determination Act 1976, the *Bundesverfassungsgericht* has explicitly accepted the assumption of the legislature made in the course of its legislative prognosis that the objective which it pursued would in fact be achieved and that any negative consequences for the operation of the undertakings concerned and the economy as such would not occur, see n. 875, p. 331. However, what can be reviewed is whether the legislature has obtained and evaluated the facts, on which its legislative decision is based, as comprehensively and correctly as possible thereby minimizing the risk of defective legislative prognoses, in particular in cases where the consequences of intervention are *not reversible* such as once ownership unbundling is actually introduced, see also n. 880. Thus, the BVerfG has granted the legislator a non-reviewable margin of appreciation with respect to how and to what extent legislative intervention *affects* fundamental rights. See also BVerfGE 90, 367, 390. The margin of prognosis reflects, primarily with regard to the suitability of a measure, the experimental character of legislation supposed to control and direct the economy, the swiftly changing economic processes and the *reversibility* of the consequences of the intervention in the case of a later failure or termination of the original legislative purpose. See also n. 880. In greater detail, Papier in Maunz/Dürig, n. 790, Article 14 no. 325.

879 It is claimed here that a measure is plainly unsuitable if a social cost benefit analysis does not show a clear positive trend. An ambiguous or tentatively negative analysis would most likely result in a disproportionate measure being taken; this is also true if expert opinions are substantially divergent, see further nn. 1009–1011 and accompanying text.

misjudgements as regards future developments to be accepted.[880] The margin of prognosis and limitation on judicial review are compensated by the legal obligation of the legislator for rectification should the law later prove to be unsuitable.

The legislature must when determining the substance and the limitations of ownership, further observe the limitations set out in Article 14(3) GG. In other words, when determining in an abstract and general way the rights and duties of ownership, the legislator has to refrain from taking any measures which lead, with respect to existing legal ownership positions, to an expropriation or which authorize the execution of an expropriation. Thus, not every unlawful determination of the substance and the limitations of ownership is to be classified as an expropriation. In particular the non-observance of the principle of proportionality or the principle of legal certainty renders a determination of substance and limitations unconstitutional, but does not render it an expropriation. The determination of substance and limitations and expropriation are two significantly different independent legal instruments.

The legislator must, when determining substance and limitations, observe the substance of Article 14(1) GG (*Wesensgehalt*)[881] as a fundamental right and as a guarantee of private property as an institution (*Institutsgarantie*).[882] Expropriation

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880 See n. 878. In particular when interferences with the right to property are supposed to control and direct the economic process, the legislature often faces uncertainty as regards the future effects of its legislation and thus has to carry out a prognosis. The requirements of objectivity and conformity of such prognoses with the constitution are primarily of procedural nature. The legislature must have evaluated the facts obtainable as they stood at the time of passing the law in an objective and reasonable manner. It must have used all information available to it in order to be able to anticipate the likely consequences of its regulations as reliably as possible. Thus, a social cost benefit analysis should be obligatory practice based on data as complete as can possibly be expected, at least in the context of fundamental rights interferences, which abolish or come close to abolishing certain fundamental rights as is the case in the context given. A mere regulatory impact assessment, which nowadays is almost common practice in legislative processes is not sufficient because it is normally rather superficial and prone to grave mistakes as the Impact Assessment of the Commission (n. 15) with respect to its proposals for further ownership unbundling measures has shown, see Part 1 Chapter 2, in particular nn. 314 seq. and accompanying text. Only if the legislator has used all the means at his disposal to obtain the knowledge required, must any errors as regards future economic development be accepted – without prejudice to the obligation of the legislator to rectify any mistakes made. The prognosis of the legislature is reasonable if it has observed these requirements.

881 See already n. 873 and accompanying text as regards the *Wesensgehaltsgarantie* of Article 19(2) GG.

882 It should be recalled that the substance of the right to property in the sense of an absolute core comprises of the usability of property for private purposes (*Privatnützigkeit*) and the unrestricted power to dispose of the subject-matter of the property. Article 14 GG guarantees the possession and the use of property. Thus, as has also already been pointed out, the *Sozialbindung* of property to the general interest is supposed to guarantee that the use of the

as *ultima ratio* can only be pursued if the special requirements for its applicability as set out in Article 14(3) GG are satisfied. Because of the compulsory guarantee of compensation (*Junctim-Klausel*), the protection of ownership does not disappear merely because an expropriation has taken place. The primary guarantee of the continuity of the right to property (*Bestandsgarantie*) is only substituted by the secondary (complementary) guarantee of the value of the property so expropriated (*Wertgarantie*).[883] This is, however, only the case for lawful expropriations; determinations of substance and limitations, which normally mean a reduction in value of the assets of the owner as a whole, or even a deprivation of assets (or a part thereof), do not in principle entail an obligation to pay compensation.[884]

Coming back to expropriation, Article 14(3) GG does not contain any definition or statements about the constituent legal elements of expropriation nor with respect to its distinction from the "regular" *Sozialbindung* of property.

In its decision of 22 May 2001 in re *Baulandumlegung*[885], the BVerfG determined the State's appropriation of an individual's property, which is directed at the complete or partial deprivation of a "concrete subjective legal position" (or ownership rights) protected by Article 14(1) 1st sentence GG in order to fulfil certain public tasks to be a core characteristic of expropriation. The BVerfG explicitly limited the definition of expropriation to cases where goods are

property and the power to dispose of it, also serves the general interest. Consequently, the legislative commitment of property must never go so far as to enable the use of the property to be exclusively useful for the general public, the State or third parties, see Papier in Maunz/Dürig, n. 790, Article 14 nos 332 *et seq.*

883 If property has, however, been lawfully acquired (even if protected from competition by way of being exempted from the application of competition law, which, however, leads to a greater *Sozialbindung*), the deprivation of corporate property, more specifically energy supply networks, for instance by demanding its sale, but also every other state measure of deprivation aimed at the divestiture of corporate property are intrusions into the substance of the right to property. This affects the guarantee of the continuity of the right to property, which exceeds the *Sozialbindung* of such property and, thus, cannot be regarded as a mere regulation of ownership. In this regard also Papier in Maunz/Dürig, n. 790, Article 14 no. 508. The fact that the owner receives the proceeds of the sale can only affect the amount of compensation to be paid, see Papier, *ibid.*

884 Compensation paments are normally not in the general interest. Only under special circumstances are compensation payments to the owner a means of making the determination of substance and limitations lawful, see Papier in Maunz/Dürig, n. 790, Article 14 no. 348. There is no guarantee of the continued existence or value of assets as regards the assets of an individual as a whole.

885 BVerfGE 104, 1, 9 – *Baulandumlegung.*

acquired on the basis of sovereign acts (*Güterbeschaffungsmaßnahmen*) – goods with which a specific public project is to be accomplished.[886]

The BVerfG further distinguishes between the special form of (direct) legislative expropriation (as opposed to (indirect) expropriation based on a law) according Article 14(3) GG and determinations (i.e. the regulation) of ownership rights according to Article 14(1) 2nd sentence GG in that the first is the deprivation of specific ownership rights of a determined or determinable group of persons whereas the latter are general and abstract determinations of entitlements and obligations with respect to ownership.[887]

However, although expropriation requires the deprivation of specific legal rights not every deprivation is an expropriation according to Article 14(3) GG. If the deprivation of legal rights is intended to balance private interests, then this is just a regulation of ownership.

The legislative regulation of ownership can be a disproportionate restriction of the capability to use and dispose of property for private purposes, which is unconstitutional. This can under certain circumstance be overcome if the legislature allows the deprivation of ownership only if hardship clauses are applied and/or compensation payments are possible.[888]

However, Article 14(1) 2nd sentence GG constitutes legislative authority for deprivation of ownership rights without compensation obligations in principle. As has already been said, a protection of the value of ownership is only granted by Article 14(3) GG. Exceeding this by making compensation obligatory even if there is no expropriation would run the danger of creating a general claim resulting from the prohibition of excessive measures. As has already been outlined, Article 14(1) 2nd sentence GG does not contain a general guarantee to maintain the value of ownership rights, and the *Sozialbindung* should not only extend to limitations on the use of property but also to limitations with regard to the value of ownership.

Thus, compensation in the context of determining substance and limitations of ownership must only be provided for along the lines of the *Denkmalschutzgesetz*

886 H-J Papier, 'Der Stand des verfassungsrechtlichen Eigentumsschutzes', in O Depenheuer (ed.), *Eigentum*, 2005, p. 96. As regards the obligation for the beneficiary of an expropriation to pay compensation, even if such a beneficiary is a natural or legal person, see Papier in Maunz/Dürig, n. 790, Article 14 nos 637 *et seq.*, 638.

887 Papier in Depenheuer, *ibid.*

888 Papier in Depenheuer, n. 886, p. 98.

case[889], where the BVerfG sets out that the guarantee of the continuity of owernship rights (*Bestandsschutz*) contained in Article 14 GG requires that above all, precautions need to be taken to ensure that the owner is not disproportionately burdened in real terms (by way of legislating for transitions, exceptions and exemptions) and that the usability of property for private purposes is maintained as far as possible. Only if in individual cases such precautions are not possible or only possible by incurring excessive costs, can financial compensation or the offer to take the property over at market value be granted to the owner.

c. Margin of appreciation and proportionality

The last subsection already contains some discussion on the margin of appreciation (of the legislature) and the proportionality principle in the specific context of the fundamental right to property. This subsection briefly expands on those elaborations, in a more general manner.

The prohibition on acting excessively (*Übermaßverbot*) or the principle of proportionality (*Grundsatz der Verhältnismäßigkeit*) has evolved into a decisive prerequisite in the area of the rule of law under the jurisprudence of the BVerfG. It is based on the concept that state measures should in principle not be unlimited and unfounded but be justified by a determinable objective and measured against such objective as regards its scale and scope (*Umfang und Ausmaß*). The principle of proportionality finds its main basis in the rule of law. It is not only applicable as between the State and individuals seeking fundamental rights protection but also as between different state institutions in circumstances where a division of the State possesses an entitlement in law or a subjective right such that it can dispose of such a right or entitlement autonomously or because a division of the State possesses competences, which take the form of a subjective right such as Article 28(2) GG for municipalities.[890]

The structure of the principle of proportionality requires that state measures are suitable, necessary and proportionate (or reasonable or not excessive) for the achievement of its legitimate objective.

The point of reference for the principle of proportionality is the legitimate objective or aim of state conduct. For the legislature such conduct consists of the

889 N. 551.

890 Grzeszick in Maunz/Dürig, n. 790, Article 20 VII no. 109.

passing of legislation in pursuance of an objective, which it has determined to be within the boundaries of the constitution.[891]

The state measure must be suitable to achieve its aim or it must at least be capable of promoting this aim. It is not necessary, however, to prove that the declared aim can be achieved entirely by the means applied; it is sufficient that the means increase the probability that the goal will be achieved at least to some extent.[892]

Further, the state measure must be necessary to achieve the aim. The necessity leg requires that the State must chose the least intrusive means amongst all the possible means available (assuming them to be equally effective), i.e. such means, which impair the protected right or entitlement the least.[893]

"Equally effective" in this context means that the available alternatives would have an equal effectiveness in achieving the relevant.[894] An alternative is however not considered equally effective if although the subject of the measure suffers less, third parties or the general public are burdened more; in particular if the alternative's costs are unreasonable such that, for instance, the State would face *unreasonably* higher financial burdens, the alternative is not considered equally effective.[895] This has rightly been criticized in that in a case such as the one just described, it was not the equality of the alternative, which was questionable; the alternative would actually be equally effective but the consequence for third party

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891 If the German legislature, either on its own account or on the basis of EC legislation decided to restructure (up to ownership unbundling) the energy supply sector in order to achieve the objectives set out in Part 1 Chapter 1, the BVerfG would not intervene (as long as these objectives are in the general interest of Germany) only because competition law based remedies are available (including the theoretically possible EC competition law remedy of forced divestiture of energy supply networks). Measures based on European legislation would be in the national public interest to the extent that European integration objectives are pursued as can be inferred from Article 23 GG; the objective of European integration includes undistorted competition in an internal market and can thus in principle also be pursued by forced divestiture permissible at EU level if proportionate. Further, the BVerfG would accept the decision of the legislature to restructure the energy sector in order to promote competition (as a legitimate objective under the German Constitution) because it would regulate the whole sector whereas competition law intervenes only in individual cases. The BVerfG would consider the legislative decision *whether* to pursue a certain objective to be within the political remit of the legislature. The question, however, how or in which manner it should be pursued, i.e. which measures are proportionate to achieve the objective, would be reviewable by the BVerfG, see further in turn.

892 BVerfGE 16, 147 *et seq.*, 183; 30, 292 *et seq.*, 316; 33, 171, 187; 67, 151, 173 et seq; 96, 10, 23 *et seq.*

893 See, e.g., BVerfGE 100, 313, 375.

894 BVerfGE 25, 1, 20; 30, 292, 319; 77, 84, 109 *et seq.*; 81, 70, 91; 100, 313, 375.

895 BVerfGE 77, 84, 110 *et seq.*; 81, 70, 91 *et seq.*; 88, 145, 164.

rights or entitlements might be more severe in the sense that they would be more impaired.[896]

Finally, the state measure must not be disproportionate to the objective or aim of the measure; the usefulness or effectiveness of the measure must not be disproportionate to the impairment its causes. Thus, the measure must be appropriate, or, for the target of the measure, reasonable. This requires that the usefulness of the measure and the impairment caused by the measure is weighed within set coordinates within which the result of the weighing process is arrived at. To determine these boundaries unequivocally is rather problematic, however, because a rational evaluation of the result (of the weighing process) is hard to achieve and to review and prone to subjective valuations. In the context of this last leg of the proportionality test, the BVerfG allows state institutions a margin of appreciation in that it assumes an infringement only in cases of manifest inappropriateness.[897]

Because of its democratic legitimation and its task of passing legislation with a wide general application, which of necessity often cannot fully reflect the complexity and diversity if the situation, the BVerfG allows the legislature considerable room for manoeuvre as regards the proportionality of legislation. When assessing the suitability of legislation, the standard of review with respect to measures of the legislature is attenuated by allowing a prognostic margin of appreciation in the context of assessing the suitability[898] and also as a political room for manoeuvre of the legislature.[899]

As regards the requirement to use the least intrusive or the mildest means, the BVerfG shows a general tendency that only relatively obvious infringements of the requirement to use the mildest means are objected to[900]; here also, the

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896 Grzeszick in Maunz/Dürig, n. 790, Article 20 VII no. 114. But see n. 260 and accompanying text.

897 BVerfGE 44, 353, 373; 96, 10, 23 *et seq.*

898 BVerfGE 25, 1, 12 *et seq.*; 30, 250, 263; 39, 210, 230 *et seq.*; 83, 1, 18; 87, 363, 383; 94, 315, 326; 98, 265, 309 *et seq.*; 104, 337, 347 *et seq.*; 105, 17, 34. It has also been accepted that the legislator bases its decision upon a justifiable prognosis. The legislature can test different concepts, see BVerfGE 78, 249, 288; 85, 80, 91, but must rectify the results if necessary, BVerfGE 25, 1, 13; 30, 250, 263; 50, 290, 332; 57, 139, 162; 95, 267, 314 *et seq.* A provision is unconstitutional if it is evidently or *per se* unsuitable, BVerfG 30, 250, 263; 39, 210, 230; 47, 109, 117; 65, 116, 126; 103, 293, 307.

899 BVerfGE 25, 1, 12 *et seq.*; 30, 250, 263; 39, 210, 231; 96, 10, 23 *et seq.*; 103, 293, 307. The scope of this latitude depends on the peculiarities of the subject-matter, the sources available to the legislator to reach a judgment and the prominence and importance of the interest protected in law, which is to be impaired, BVerfGE 50, 290, 332 *et seq.*; 73, 40, 92.

900 BVerfGE 25, 1, 19; 30, 292, 319; 53, 135, 145; 81, 70, 91; 98, 265, 308 *et seq.*; 96, 10, 23 *et seq.*; 101, 106, 128; 101, 331, 349 *et seq.*; 102, 197, 218; 105, 17, 36.

legislator is afforded a margin of "tenability"[901] or appreciation.[902] The same applies, as has been said above, to the last leg of the test, i.e. the evaluation of proportionality in a narrow sense where the weighing of the different interests takes place.

d. Subject of protection

The protection of private subjects, which includes private shareholders, seems to be a rather straightforward matter under German constitutional law. However, the fundamental rights protection of network owners under German constitutional law has been questioned. Thus, after some brief discussion of the protection of private subjects, it will be clarified that network owners do enjoy fundamental rights protection under German constitutional law. It will also be discussed whether and to what extent public undertakings and public shareholders should, in the context given, also – exceptionally – enjoy fundamental rights protection.[903]

aa. Private subjects

It is beyond any doubt that any privately owned energy supply undertakings or vertically integrated undertakings such as network companies (owning and/or operating energy supply networks) in principle enjoy protection of their right to property under German law.[904] Under German constitutional law, for privately owned energy supply undertakings incorporated under German law, this follows from Article 19(3) GG. Also protected are (their) shareholders[905], at least private

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901 *Vertretbarkeitsspielraum*: BVerfGE 98, 265, 308 *et seq.*

902 *Einschätzungsspielraum*: BVerfGE 102, 197, 218.

903 See the discussion in section III of this chapter.

904 See, however, Hermes, n. 641, who puts *infra*structure networks in telecommunications, energy and railway on the same footing with road *infra*structure and thus generally categorizes them as public institutions, which do not enjoy fundamental rights protection because of the privilege of *infra*structure owners to expropriate land owners in the course of *infra*structure construction (see s. 45(1) EnWG). But see for instance Pielow, n. 641, pp 625 *et seq.*, representing the vast majority of legal opinion, and Pielow, n. 765, pp. 45–54. See also in more detail *infra*.

905 Apart from the fundamental right to property of the vertically integrated ESUs according to Article 14, 19(3) GG, German constitutional law also protects the right to property of (at least) private shareholders of such undertakings, see BVerfG, 30 May 2007, 1 BvR 390/04, with comments by L Leuschner, 'Gibt es das Anteilseigentum wirklich?', (2007) NJW 3248, BVerfGE 14, 263, 276. See H Jarass, B Pieroth, *GG – Kommentar*, 5th ed., 2000, Article 14 no. 9. In a corporate setting the property of the shareholders in the holding company must be distinguished from the property sphere of the holding company, which holds the shares in the network subsidiary (principle of separation of corporate property spheres as a consequence of the separate legal personality of corporate bodies). See in this respect the at times confusing approach of the ECtHR, n. 1190 *infra*. By contrast and just mentioned in passing, the protection in this regard of shareholders under the ECHR seems not to be as far reaching as the victim

ones, which are either German nationals or legal persons incorporated in Germany.[906]

Excursus: network owners and German fundamental rights protection

Having said this, it is nevertheless worthwhile to look into the arguments, which seek to deny network owners fundamental rights protection in Germany, as this plays some role in the context of the *Sozialbindung* of ownership in Germany and the proportionality of further unbundling measures. It also serves as a link to the discussion whether public or public private energy supply undertakings or their public shareholders (should) enjoy fundamental rights protection in Germany.

It is claimed that *infra*structure networks such as energy supply networks are public *infra*structures whose owners are therefore not eligible for fundamental rights protection when the State determines their obligations in the general interest.[907] This view has been expressed in the context of the debate as to whether and to what extent network owners have to grant TPA to their networks, in particular when capacity is constrained.[908]

Previously, the discussion of the eligibility of network undertakings for fundamental rights protection had mainly taken place in the context of public, mainly municipal or communal, undertakings or private undertakings controlled by the State or municipalities. The *HEW* decision of the *Bundesverfassungsgericht* in 1990 denied their capability to rely on such protection because the State or public institutions, which are part of the state organization, such as municipalities, are generally not protected by fundamental rights but are bound by them

status of shareholders according to Article 34 ECHR for shareholders is not entirely clear. So far, the ECtHR has only in exceptional circumstances recognized the right to property of shareholders by "piercing the corporate veil", see only ECtHR, *Agrotexim* v *Greece*, 24 October 1994 (also referred to as *Fix Brewery*), Ser. A330-A, in particular no. 66. See further chapter 5 on Great Britain.

906 See n. 961 as regards fundamental rights protection for shareholders, which are foreign nationals or foreign legal persons. They do also enjoy, in the context given here, equivalent fundamental rights protection in Germany and also under Germany constitutional law but based on different legal bases.

907 Hermes, n. 641.

908 See in this regard the current state of the law: Articles 9(e), 14(2), 20(2) Electricity Directive 2003, Articles 8(1)(b), 12(2), 21(1) Gas Directive 2003; see also ss 20(2), 21(1) EnWG. See Papier, n. 770, pp 221 *et seq.*, for expressing doubts about the validity of such provisions under German constitutional law; Papier is president of the *Bundesverfassungsgericht*. Similar also Pielow, n. 765, p. 46, note 10 with further references. The following discussion relies to a large extent on Pielow, n. 765.

according to Article 1(3) GG, and by reference to their objective to serve the public or general interest.[909]

These views are, however, disputed because it is claimed that such undertakings would indeed be capable of relying on fundamental rights protection as long as they did not pursue an objective, which could only be fulfilled by the State but one which participates in competition like every private undertaking and are bound by the same competitive obligations.[910]

The view that denies fundamental rights protection to *infra*structure network owners refers to the comprehensive state responsibility for the *infra*structure classifying the provision of supply networks, in particular in the areas of rail transport, telecommunications and energy supply, as a public task. Private undertakings controlled by private or public shareholders are regarded as bound to serve the general interest, which is the expression of the right of third parties to use and access such *infra*structures. This right is to be valued significantly higher than the interest of network owners. This view is based on the argument that these *infra*structures were built by using the property of third parties, which had to be expropriated for this purpose. Thus the beneficiaries of such expropriations would be bound by an obligation to serve the general interest, which takes priority over private ownership interests, and which is determined by planning and network access decisions of the State.

The special responsibility of the State to guarantee the provision of *infra*structure (*Gewährleistungs-* or *Infrastrukturverantwortung*) has already been outlined. In particular with respect to *infra*structure networks, this responsibility is said to be determined by their extensive space requirements (*Raumbedarf*), which can often only be satisfied by relying on rgw property of third parties and which in turn would further increase the State's responsibility to guarantee the provision of such *infra*structure. The degree of this responsibility would depend on whether one deals with primary (transmission) networks, such as roads, rail tracks, canals, and high voltage grids – or with secondary more locally confined (distribution) networks.

This view that energy supply networks are public facilities would deprive privately controlled network operators of their fundamental rights expressed in Articles 12(1) GG and 14(1) GG, which they could otherwise invoke against the regulation

909 BVerfG, 16 May 1989, 1 BvR 705/88 – *HEW*.

910 See M Fehling, 'Mitbenutzungsrechte Dritter bei Schienenwegen, Energieversorgungs- und Telekommuikationsleitungen vor dem Hintergrund staatlicher *Infra*strukturverantwortung', (1996) AöR 60.

of such facilities and any arbitrary decisions of the legislature. Any obligations or restrictions imposed on the use of the networks such as wide-ranging network access obligations (TPA) or the obligation to invest into the networks as well as a possible duty to accept the third party use of their energy networks below cost would have to be accepted by the network owners without any possibility to object.

The vast majority of legal opinion in Germany, however, opposes this rather singular view. State intervention in the form of determining network ownership and operation is rather and primarily seen as regulation of ownership (determination of substance and limitations – *Inhalts- und Schrankenbestimmmungen*), which is inherent in the right to property as laid down in Article 14(1) GG, which is subject to the proportionality test.[911]

Further, this singular view outlined before has been comprehensively rebutted[912]: The assumption that the provision of *infra*structure networks always requires the expropriation of third parties' property is rather doubtful. Apart from the fact that often simple rights of way suffice, an expropriation according to Article 14(3) GG always has to observe the principle of proportionality and is the *ultima ratio* in order to obtain the means required to create the space for *infra*structure networks, which also significantly constrains the powers of the *infra*structure undertakings in this regard.

It is an overriding legal requirement, which is also observed in practice, that the various interests have to be weighed and balanced first, before any conflicts can arise with respect to the use of the space required. This means that the property owners and the undertaking pursuing an *infra*structure project normally negotiate and agree the transfer of rights *in rem* or the rights to use (parts of) the relevant property.[913] This does, however, not negate the fact that expropriations in particular to the benefit of electricity network projects occur frequently.[914]

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911 H-J Papier, 'Durchleitungen und Eigentum', (1997) Betriebs-Berater (BB) 1213, and n. 770; Fehling, *ibid*.; also critical to Hermes, J Dannischewski, Unbundling im Energierecht, 2003, pp. 199–242.

912 Pielow, n. 765, with further references.

913 The incentive for voluntary agreements is that the relevant property can usually be sold at a price at or near to its market value even though the mere threat of expropriation often influences the sales negotiations to the detriment of the property owner.

914 An additional argument against the claim that the expropriation powers of *infra*structure undertakings lead to an increased general interest in the *infra*structure is that the obligation to guarantee the provision of energy *infra*structure in order to safeguard the general interest would primarily depend on whether and to what extent a *specific* energy *infra*structure project has required an expropriation according to Article 14(3) GG.

Further, the conclusion that the State is not bound by the fundamental rights of the network owners but, on the contrary, bound by the fundamental rights of those whose property was expropriated in favour of an *infra*structure project in the public interest, is biased towards the interest of property owners whose property rights are only potentially affected (in the future).[915] Such a conclusion does not sufficiently reflect the general prohibition on excessive measures (*Übermaßverbot*) flowing from the rule of law, which is an inherent element of expropriation as set out in Article 14(3) 1st sentence GG. The danger is that the proportionality principle risks becoming meaningless if it is accepted that the general interest is applied to network operators more strictly.

More generally, linking private network property indistinctively to the general interest appears doubtful. This is because expropriations in the context given normally force property owners to transfer the right *in rem* to *use* the property, exceptionally also through the complete deprivation of a part of the property concerned. The property so expropriated thus serves the general interest in network-bound supply of energy to the general public and the expropriation exclusively concerns the use of this specific property.[916] It thus remains unclear in the face of the relationship between the subject of expropriation and the purpose of the expropriation how the general interest can extend to the private investment or even to the ownership of such parts of the network as are clearly not based on state intervention. Should the general interest subjection of private network property be correct then network owners could also be forced to invest into the networks additionally to their maintenance obligations, an extra obligation, which has not been seriously proposed so far.

Further, the power to impose general transport and transmission (common carrier) functions on the network ensue neither directly nor indirectly from Article 14(3) GG, but require a foundation in law (*Gesetzesvorbehalt*), which would then first have to be measured against the fundamental rights standard of Articles 12(1) and 14 GG.

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915 Even more so because it is not taken into account that property affected by *infra*structure projects also serves the general interest. Electricity customers, for instance, which are connected to the local grid, are usually obliged to accept the laying of cables and other appliances related to electricity supply across their property. Such an obligation reflects the attachment to the general interest, the solidarity of each property owner with the community of electricity consumers.

916 The expropriation of property is indeed supposed to enable the *infra*structure owner to fulfil a task in the general interest, not to deprive private owners of their property. Further, if network connections or reinforcements become necessary as a result of the need for more network capacity, expropriations are not necessarily in the interest of the network owner only, but primarily in the interest of the new connections and existing customers, which require more energy.

Consequently, the contention that in so far as the construction and operation of networks are concerned, the position of an energy supply undertaking results solely from expropriation, which itself is the consequence of the state responsibility to provide *infra*structure is not true in two respects. First, expropriation is not the sole means to being able to build supply networks. Secondly, a network undertaking does not obtain its position from expropriation but primarily from its investment in the networks. To confer upon the energy networks a general transport and transmission role (common carrier) as soon as they start operating would result in a (legal) fiction, which is not compatible with the limits inherent in the regulation of the right to property according to Article 14 GG.

To regard private investment as being the result of the conferral to private parties of a public responsibility to build and operate networks as public facilities is not unproblematic. First of all, such a responsibility would initially have to be a responsibility of the State or its subdivisions, either explicitly or based upon an authorization within the limits of the constitutional order to assume such a responsibility or task. If private parties act for the State, the question is whether they do so for genuinely private economic reasons and protected by the relevant fundamental rights or whether such economic operation is the result of a functional privatization of tasks, which are actually in the remit of the State. A prerequisite for the latter is that the fact that the task to be pursued falls within the responsibility of the State must be made public. Such a responsibility must be based on a law or even on a constitutional provision, which clearly indicates the specific task as falling within the responsibility of the State. If energy supply was to be a public task, the underlying responisbility or pulic nature of this task would thus have to be laid down in a formal law. This is because such a "public" task is something which can in principle also be pursued by the private sector because it does not require the exercise of sovereign rights.[917] The designation of a task as falling within the public responsibility thus requires a legal basis. This follows from the principle that substantive issues must be dealt with by parliamentary laws (*Wesentlichkeitsgrundsatz*), as such a designation would shift the boundaries of the relationship between the State and society, which would entail a limitation of the range of activities guaranteed by fundamental rights.

As has already been pointed out, there are no legal provisions, which make the actual operation of energy networks a public task. The responsibility for guaranteeing the provision of (energy network) *infra*structure based on the *Sozialstaatsprinzip* (see already above) comprises a general duty to afford

[917] Which is an argument for municipalities actually acting as competitors to private parties in the energy supply market, which should thus give them protection similar to what private parties enjoy, in order to create and maintain a level playing field. See further *infra*.

everybody access to basic supply or universal services under socially adequate conditions in situations of market failure, i.e. where private provision has failed. However, the responsibility for fulfilling specific services such as the operation of energy networks or energy supply *on* the network, are not nationalized, i.e. in the sole remit of the State. At most, there is a residual duty of the State to take over energy supply in cases where the private sector performs poorly or is clearly failing.

The EnWG is neutral with regard to who should carry out energy supply, i.e. there is no bias towards the State to fulfil this task. On the contrary, the generalized right to use public ways (subject to paying concession fees) according to section 46 EnWG indicates that the creation of a public monopoly on networks is indeed not intended (as can also been inferred from the general supply obligations of the EnWG, see above). All of this shows that the State has actually declined pursuing the energy supply task itself but confines itself to regulating the private performance of this task.[918] It is thus not a question of identifying energy supply as a public task, which would exclude fundamental rights protection but rather to establish the compatibility of regulatory requirements of network ownership and operation with the fundamental rights and their application in each individual case.

To infer from section 19(4) no. 4 GWB[919] that the operation of energy networks is a public task is not correct either. This provision merely mandates the obligatory conclusion of contracts between competitors as a consequence of an abuse of a dominant position by *infra*structure owners, which, in any event, must be established first in each individual case, and not as the result of the existence of, or with the effect of establishing a public task. Recognizing the need to force dominant *infra*structure owners to enter into access agreements means that the right to dispose of such an "essential facility" for the owner's benefit and, thus, the ability to rely on the protection of the right to property according to Article 14 GG has been implicitly recognized.[920]

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[918] As to the comparison with other network-bound sectors delivering similar results, see Pielow, n. 765, p. 53, also rightly indicating that any apparent reference in the EC Treaty or secondary European legislation, for instance as regards trans-European networks in Article 154(2) 1st sentence EC, to national networks should not lead to the conclusion that the operation of networks has been made a public task. This would be in contradiction to the neutrality of the EC Treaty expressed in Article 295 EC with regard to the property systems of the Member States, and would also be in conflict with the exclusive competence of the Member States to define services of general (economic) interest according to Article 86(2) EC.

[919] Which in a competition law context, see Part 1 Chapter 2, deals with the refusal to grant access to essential *infra*structure facilities in the context of the abuse of a dominant position.

[920] Again, a similar protection should be afforded to municipalities via Article 28(2) GG; s. 19(4) no. 4 GWB also applies to municipalities and distribution networks owned and operated by

bb. Public subjects

It has already been explained that in principle, public undertakings or public legal persons, or better, legal persons under public law (*juristische Personen des öffentlichen Rechts*) such as municipalities (*Körperschaften des öffentlichen Rechts* – legal corporations under public law) and private legal persons wholly owned by such public legal persons are not able to invoke fundamental rights such as Articles 12, 14 and 9 GG. The State and its subdivisions are committed to observe fundamental rights (Article 1(3) GG), which means they are in principle not entitled to fundamental rights protection, which they are committed to observe.[921]

In this context, the BVerfG[922] assesses the function, "in which the legal person under public law is pursuing an act of state sovereignty. If such a function consists in fulfilling *public tasks*, which have been *assigned by law*, then the legal person is *to that extent* not capable of fundamental rights protection [emphasis added]." Thus, Article 19(3) GG[923] applies to the extent that the legal person "is directly attributable to an area of life, which is protected by fundamental rights."[924] The BVerfG[925] interprets the "essence" formula of Article 19(3) GG in such a way that the inclusion of "legal persons in the scope of protection of certain substantial fundamental rights is only justified if their incorporation and activity is the expression of the free development of private natural persons." In other words, the inclusion of legal persons in the scope of protection of certain fundamental rights is nothing else than a form of collective exercise of fundamental rights by individuals entitled to these fundamental rights.[926]

Thus, it appears that it does not primarily matter whether the legal person is constituted under public or private law. This is reflected by the fact that legal persons under public law can participate in public private undertakings (*gemischt-wirtschaftliche Unternehmen*), which can be incorporated in a private legal form (which they often are) or in a public legal form[927] where genuinely sovereign tasks are not at stake but such tasks, which can also be accomplished

them.

921 In this respect also Scholz in Maunz/Dürig, n. 790, Article 12 no. 108.

922 BVerfGE 68, 207.

923 "The fundamental rights shall also apply to domestic legal persons to the extent that the essence of such rights is applicable."

924 See only BVerfGE 107, 299, 309 *et seq.*

925 BVerfG, 16 May 1989, 1 BvR 705/88.

926 Scholz in Maunz/Dürig, n. 790, Article 12 no. 108.

927 See in greater detail, Ruthig/Storr, n. 780, no. 450.

by private parties, such as services of general (economic) interest.[928] Thus, when services of general (economic) interest, which the State must in principle guarantee (*Gewährleistungsverantwortung*), are pursued by public private undertakings, then the function of such undertakings is a private economic or private law one, to the extent that full fundamental rights protection of the private shareholders of this public private undertaking must be guaranteed.[929] In other words, it is not so much a matter of what legal form a legal person has but solely of the specific function such a legal person fulfils and whether and how far this function can ultimately be attributed to the exercise of fundamental rights by private persons[930], so that it actually does not matter whether such public private undertakings are publicly or privately controlled.[931]

Coming back to the principle that legal persons of public law, which pursue an economic activity, cannot rely on fundamental rights protection, and taking into account what has just been said, there are obviously exceptions to this rule where the "functional identity of activities" (*funktionale Tätigkeitsidentität*) exists.[932] Such an identity exists where areas of life protected by fundamental rights have been opened (not necessarily exclusively) to the fulfilment of public tasks such as for universities, religious communities and public broadcasting corporations[933] but also, for instance, where *legitimate public economic activities* (such as energy supply, which, as has already been explained above, belongs to the original sphere

928 See, for instance, H Jarass, *Die EU-Grundrechte*, 2005, §4 nos 32 *et seq.*; W Cremer, 'Eigentumsschutz', in T Marauhn, R Grote (eds), *Konkordanzkommentar zum europäischen und deutschen Grundrechtsschutz*, 2006, ch. 22, no. 61; Müller-Michaels, n. 535, p. 43; even more comprehensively, M Burgi, 'Die öffentlichen Unternehmen im Gefüge des primären Gemeinschaftsrechts', (1997) EuR 261, 287 *et seq.* Services of general (economic) interest is a mere sociological definition, which does not tell anything about whether they are to be pursued by the State or private parties, see Scholz in Maunz/Dürig, n. 790, Article 12 no. 108.

929 Ruthig/Storr, n. 780, no. 450, rightly distinguish between private shareholders protected by fundamental rights such as Article 14 GG and the question whether their fundamental rights protection continues to exist in public private companies, which can only be answered after applying Article 19(3) GG.

930 See Scholz in Maunz/Dürig, n. 790, Article 12 no. 108.

931 The German legal order has conferred upon legal persons under private law legal autonomy and independence without looking at their shareholding structure as this would not only conflict with the non-discrimination principle but would also infringe the neutrality of the competitive process. The question of whether public shareholders control an undertaking cannot be the decisive criteria because normally, the undertaking is entitled to fundamental rights protection, not its shareholders.

932 Scholz in Maunz/Dürig, n. 790, Article 12 no. 108.

933 BVerfGE 15, 256, 262; 18, 385, 386 *et seq.*; 21, 362, 373 *et seq.*; 51, 77, 87; 53, 366, 386; 59, 231, 254; 61, 82, 102; 68, 193, 207; 74, 297, 317 *et seq.*; 78, 101, 102 *et seq.*; 107, 299, 309 *et seq.*

of activity of municipalities)[934] compete with private ones in the context of services of general (economic) interest.[935]

As long as there exists such (legitimate) competition, it is thus suggested here that public undertakings enjoy fundamental rights protection according to Article 19(3) GG as construed by the BVerfG[936] with respect to exactly this sort of competition, i.e. they enjoy the right to competitive equality (*wettbewerbliche Chancengleichheit*) according to Articles 12 and 3 GG, which prohibit the giving of unfair advantage to private competitors.[937]

As regards the right to property according to Article 14 GG, it also seems not to contradict the jurisprudence of the BVerfG as outlined above if one distinguishes between property, which municipalities (and other public undertakings) dispose of when fulfilling public tasks assigned by law, and that which they dispose of when they participate in activities other than acts of state sovereignty. For state measures against the latter sort of property, they should also be able to invoke fundamental rights protection according to Article 14 GG.[938]

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934 Original sphere of activity (*eigener Wirkungskreis*) as opposed to the sphere of activity conferred upon the municipalities by the State (*übertragener Wirkungskreis*), the associated tasks of which have to be fulfilled by the municipalities as original state activities. Whether, how and when legal persons under public law (are allowed to) become active economically depends on the relevant regulations which allocate competences to them. For municipalities and their economic operations, this results from the guarantee of municipal self-administration according to Article 28(2) GG, which means that limitations of municipal economic activity on the basis of laws regulating municipal matters (*Gemeindeordnungen*) can not be circumvented by invoking fundamental rights protection, in particular Article 12 GG. In this respect, municipalities can only rely on Article 28(2) GG itself, which approximates, in the context given, to the role of Articles 12 and 14 GG, see already *supra*.

935 See Scholz in Maunz/Dürig, n. 790, Article 12 no. 110. M Schmidt-Preuß, 'Energieversorgung', in J Isensee, P Kirchhof (eds), *Handbuch des Staatsrechts der Bundesrepublik Deutschland*, Band IV, 3rd ed., 2006, § 93, nos 37 *et seq*., goes as far as arguing that wholly publicly owned undertakings such as *Eigengesellschaften* and other forms of legal persons in complete public ownership, should enjoy fundamental rights protection if they take part in competitive energy supply. *Gemischt-wirtschaftliche Unternehmen* and *Eigengesellschaften* both have in common that their budget is separate from that of the public shareholders.

936 See *supra*.

937 See Scholz in Maunz/Dürig, n. 790, Article 12 no. 115.

938 See Maunz in Maunz/Dürig, n. 790, Article 28 no. 59. This can also be based on the fact that the area of fundamental rights protection can be extended beyond federal constitutional law by *Länder* constitutional law (see Article 142 GG), see Maunz, *ibid*., with further references. Thus, it is indeed possible in special cases that municipalities can according to *Länder* constitutional law rely on their right to property against acts of a *Länder* legislature, see, for instance, the jurisprudence of the Bavarian Constitutional Court BayVGH, BayVGHE 10, 113; 19, 16; 20, 114; 22, 48; 23, 62; 26, 144. Thus, this should similarly also be assumed for municipalities relying on fundamental rights such as Article 9 GG (freedom of association) and Article 12 GG, see Maunz, *ibid*.

As has already been indicated above, the BVerfG has denied public and public private undertakings, the latter active in energy supply, fundamental rights protection in earlier decisions.[939] For the reasons given above, it is, however, doubtful whether this ruling would be upheld today. A recent decision of the BVerfG indeed indicates that the Court might actually seriously reconsider the position taken in its 1990 *HEW* ruling.[940]

Finally, another argument why the distinction between public private undertakings under public control on the one hand and private control on the other does not seem appropriate is that it would impair legal certainty considerably if in the case of an energy supply undertaking (such as RWE, for instance, which has a very strong public shareholder base)[941] listed at the stock exchange, the admissibility of a reliance on fundamental rights protection would depend on quick movements of share transactions. Thus, publicly controlled energy supply undertakings such as EnBW, which is *de facto* controlled by a 45,01% stake owned by an association of communal bodies (and by another 45,01% stake of the French state owned EDF) should indeed be capable of relying

939 BVerfGE 75, 192; BVerfG, 15 August 1994, 2 BvR 1430/94 – *Sparkassen*; BVerfG in re *HEW*, n. 909. See generally V Epping, *Grundrechte*, 3rd ed., 2007, no. 154. As regards critical comments and more recent tendencies in the literature and case law, see Schmidt-Preuß, n. 935. As regards the latter decision, the Court, however, neglected the fundamental rights protection of the public private energy supply undertaking at least to the extent that it also replicates the economic activity of its private shareholders. The protection of the private shareholders' fundamental rights in their capacity as shareholders is indeed a question to be considered separately here. More generally in this respect, Ruthig/Storr, n. 780, no. 450.

940 BVerfG, 14 March 2003, 1 BvR 2087/03, 2111/03, nos 71 *et seq.*, accepting *Deutsche Telekom AG*'s (which is *de facto* controlled by the Federal Republic of Germany with its approx. 43% shareholding) ability to benefit from the fundamental rights of Articles 12 and 14 GG; it, however, emphasizes that the German State is, for factual and legal reasons, not able to exercise control over *Deutsche Telekom*. Otherwise, the reliance of *Deutsche Telekom*, and more generally of undertakings with public shareholders, on fundamental rights protection might still be doubtful, see no. 72 of the decision. In BVerfG, 18 May 2009, 1 BvR 1731/05 – *Mainova*, the BVerfG indeed upholds its stance (already articulated in its 1989 *HEW* decision, n. 909, that at least a public shareholding (by a municipality) in a private (energy supply) undertaking amounting to more than 75% (which includes the corrsponding control rights) does not allow such an undertaking to rely on fundamental rights protection, which would not be obtainable by simply conducting a business in a private legal form (so-called "Flucht ins Privatrecht"). The Court bases its decision also on the qualification of energy supply as a public task. It has, however, been argued here that this qualification should not lead to the refusal of fundamental rights protection. Contrary to what has been discussed here the Court has also not taken into consideration whether sovereign powers are exercised; only if this was the case should fundamental rights protection be refused.

941 The transmission system operators RWE, E.ON and EnBW have minority municipal shareholders whereas the fourth transmission system operator Vattenfall is wholly owned by the Swedish state owned Vattenfall. The German distribution system operators are frequently in municipal ownership.

on fundamental rights protection.[942] The case of EnBW actually provides another argument why German public shareholdings should enjoy fundamental rights protection: the fact that foreign state owned shareholders such as EDF and Vattenfall do enjoy fundamental rights protection in Germany[943] would put German public shareholders at a further disadvantage.

According to what has just been discussed, the view is taken here that municipalities are able to rely on the fundamental rights protection of Articles 12 and 14 (as well as 9) GG in the context given. They, however, can only rely on these fundamental rights as long as the economic activity of energy supply has not been legitimately taken away from them by the State or their undertakings have not been legitimately privatized by the State.[944]

2. FREEDOM OF OCCUPATION AND ECONOMIC ACTIVITY, ARTICLE 12(1) GG

The freedom of occupation and the right to property according to Article 14 GG are closely related. In their economic functions, both fundamental rights in principle protect the same subjects. Subject-matter of the protection of Article 14 GG is – via the right to own established and active economic operations (*Recht am eingerichteten und ausgeübten Gewerbebetrieb*)[945] – the substance of the property rights used for economic purposes such as ownership of production assets.[946] Article 12(1) GG, on the other hand, protects free economic activity[947], which directly relates to the economic safeguards of Article 14 GG.[948] Subject-matters of both fundamental rights are thus the general freedom of economic and entrepreneurial activity, which comprises, inter alia, of the freedom of

942 M Schmidt-Preuß, *Kollidierende Privatinteressen im Verwaltungsrecht*, 2nd ed., 2005, pp. 68 *et seq.*, 717 *et seq.*

943 See, in greater detail, n. 961.

944 Against these state organizational measures, municipalities can only rely on Article 28(2) GG, whose effects have already been discussed above. Thus, municipal energy supply undertakings do not enjoy the same degree of guarantee of continued existence (*Bestandschutz*) as their private competitors do.

945 See Papier in Maunz/Dürig, n. 790, Article 14 nos 95 *et seq.*

946 Scholz in Maunz/Dürig, n. 790, Article 12 nos. 130–132, 147, 150, with further references.

947 BVerfGE 50, 290, 363. This right is also applicable to domestic legal persons. For municipalities, see already *supra*.

948 According to the BVerfG, Article 14(1) GG protects what has been acquired, i.e. the result of an activity, whereas Article 12(1) GG protects the acquisition of it, i.e. the activity itself, See only BVerfGE 88, 366, 377. In other words, the freedom of occupation and economic operation protects the freedom of acquisition whereas the right to property protects the continuity of an acquisition (resulting from a business activity or from practising an occupation) and the property rights deriving from economic acquisition.

competition or the participation in the competitive process[949] including free market access[950] and the freedom to invest[951], without obstacles or distortions raised by the State.[952] Article 12(1) GG is thus applicable parallel to Article 14 GG (*Idealkonkurrenz*).[953]

On the other hand, the right to property according to Article 14 GG does not protect against the loss or restriction of *the opportunity* to earn money or of any sales markets or market shares, i.e. to put it more generally, entrepreneurial opportunities are not protected. The freedom of occupation and economic activity according to Article 12(1) GG does not protect against competition or reductions in business volume or in opportunities to earn money as a result of competition.[954] The freedom of occupation according to Article 12(1) GG, however, protects against restrictions on how (or whether at all) an occupation can be chosen and how is should be pursued.

With regard to goals of economic and social policy, the legislator possesses a wide margin of appreciation.[955] As Articles 12 and 14 GG normally carry essentially the same limitations[956], in particular as regards the constitutional reservation that limitations can only be set by law (*Gesetzesvorbehalte*) which is contained in Articles 12(1) 2nd sentence, 14(1) 2nd sentence GG[957], the proportionality aspects discussed in the context of the possible introduction of an ISO model are also applicable here.[958]

949 See BVerfGE 32, 311, 317.

950 Which, according to the BVerfG, is solely protected by Article 12 GG, see, for instance, BVerfGE 110, 274, 288.

951 Scholz in Maunz/Dürig, n. 790, Article 12.

952 Thus, the exemption of energy supply undertakings from the application of competition law according to the old s. 103(1) GWB, see *supra*, which resulted in the creation and acceptance of monopolistic energy supply closed to competition, infringed the rights resulting from Article 12(1) GG of those undertakings which did not have the "privilege" to be part of this "energy supply circle".

953 Scholz in Maunz/Dürig, n. 790, Article 12.

954 Papier, n. 770, p. 222. This is the reason why, in the context of current legislation, the reductions in sales caused by competition can be taken into account when establishing whether there are any free network capacities for the vertically integrated network undertaking to honour network access requests from third parties.

955 Haslinger, n. 35, p. 349.

956 BVerfGE 50, 290, 364.

957 More differentiated, Scholz in Maunz/Dürig, n. 790, Article 12 no. 150.

958 See Papier, n. 770, p. 223.

3. FREEDOM OF ASSOCIATION, ARTICLE 9(1) GG

The freedom of association according to Article 9(1) GG (*Vereinigungsfreiheit*) guarantees the freedom to form associations and corporations (*Vereine und Gesellschaften*). Article 9(1) GG inter alia protects the autonomy of the association to organize itself internally, which includes the choice of the group structure (incl. the legal form of the undertaking) and the allocation of undertakings within the group (*Konzerngestaltungsfreiheit*)[959], subject to regulation by company and corporate law.[960]

More importantly, however, Article 9(1) GG particularly protects those purposes of association, which are already protected by fundamental rights granted to individuals. Thus, Article 9(1) GG often applies in the context of, for instance Articles 2(1) (general freedom of action – *allgemeine Handlungsfreiheit*)[961], 12 (freedom of economic operation – *Freiheit der wirtschaftlichen Betätigung*) and 14 GG (right to property).[962] In other words, the freedom of association can be described as a mere right to "exercise" collectively a certain purpose legitimized by fundamental rights ("Ausübungsrecht") where this purpose finds its

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959 For the principle of autonomous organisation and free (and collective) self-determination, see BVerfGE 50, 290, 354 – *Mitbestimmung*. See also Schmidt-Preuß, n. 539, p. 38, and P Badura, 'Netzzugang oder Mitwirkungsrechte Dritter bei der Energieversorgung mit Gas?', (2004) DVBl. 1189, 1196. Public entities and corporations are not protected, see Scholz in Maunz/Dürig, n. 790, Article 9 nos 73 *et seq.* See, in greater detail, as regards the subject-matters of protection of Article 9(1) GG, Scholz in Maunz/Dürig, n. 790, Article 9 nos 42 *et seq.*

960 Because the freedom of association is aimed at collective action, it does not help against restrictions which would apply to the individual to the same extent as they apply to the association. Thus, the activity of the association is subject to the law (for instance, company law) in the same way as the actions of individuals, see Scholz in Maunz/Dürig, n. 790, Article 9 nos 86–7.

961 The fundamental right of Article 2(1) GG, which guarantees the general freedom of action (and thus, for instance, also economic activity and contractual freedom) only comes into play if no special fundamental right is applicable, such as Articles 14, 12(1) and 9(1) GG. Article 9(1) and 12 GG only protect German nationals, while Article 14 (albeit a fundamental right applicable to any natural person) as a result of the effect of Article 19(3) GG (which facilitates the applicability of fundamental rights to domestic legal persons if suitable), does not protect foreign legal persons and any of their share ownership. Thus, foreign natural and legal persons (such as Swedish Vattenfall and French EdF) if not protected by these rights can only rely (to a limited extent) on Article 2(1) GG, which guarantees the general freedom of action (and thus, for instance, also economic activity and contractual freedom) and, if applicable, the fundamental rights and freedoms as protected on EU level as well as by the ECHR and its protocols and by, for instance, Article 10 of the Energy Charter Treaty; as to the Energy Charter Treaty, see n. 97. The latter, i.e. ECHR and Energy Charter Treaty do, however, not rank as fundamental rights in Germany, see *supra*. See, in greater detail, Scholz in Maunz/Dürig, n. 790, Article 9 nos 41, 47, 111, Article 12 no. 104; Papier in Maunz/Dürig, n. 790, Article 14, nos 217, 218.

962 Scholz in Maunz/Dürig, n. 790, Article 9 no. 39.

constitutional legitimacy in certain fundamental rights defined in content and substance ("Inhaltsrecht"), such as Articles 2(1), 12 and 14 GG.[963]

As explained above, more restrictive unbundling measures are sought to be enforced inter alia for competition reasons. Thus, the primary target is not the structure of the vertically integrated energy supply undertakings which is "only" a necessary consequence. Consequently, it is primarily Articles 14 and 12 GG which are interfered with[964], and with them Article 9(1) GG, which protects the (collective) exercise of these rights, i.e. the way and in the structure in which these undertakings want to use them.[965] Consequently, as Article 9(1) protects the (collective) exercise of the "substantial" rights deriving from Articles 14 and 12 GG, the restrictions of these rights[966] also restrict the right in Article 9(1) GG.[967]

These restrictions can, however, only be applied to Article 9(1) GG as long as they pass the proportionality test. Consequently, no further explicit discussion of the compatibility of the unbundling measures assessed here with the freedom of association according to Article 9(1) GG is required[968]; any (new) company law related restrictions in the area of (private and public) limited liability companies

963 The commercial activity of the association is then not primarily protected by Article 9(1) GG because to that extent the association and its activity do not in themselves need fundamental rights protection. In this respect, the protection rather derives from substantive fundamental rights, such as Articles 14 and 12 GG, see BVerfGE 70, 1, 25.

964 As will be examined in greater detail with respect to Article 14 GG in section V. For the interference with Article 12(1) GG, see n. 1008.

965 As in the present context, the structure of the association and its purpose often cannot be clearly distinguished; rather, the structural requirements associated with the purpose of the association also determine the organizational structure of the association, which makes the determination of the applicable fundamental rights being restricted problematic. As soon as Article 9(1) GG is to be applied in combination with other fundamental rights, as is the case here, the restrictions to Article 9(1) GG as well as to the other fundamental rights, here Articles 14 and 12 GG, are applicable. Only if the motives and resulting therefrom the aim of state intervention can be determined, is only one or the other of the restrictions applicable (otherwise both are applicable).

966 Which will also be elaborated upon in section V.

967 Apart from the restrictions of Article 9(1) GG as set out in Article 9(2) GG, the legislator is entitled to restrict the operation of an association in so far as it is necessary to protect other legally protected interests and in so far the interests of common welfare as safeguarded by the State are of equal importance to the encroachment upon the freedom of association, see BVerfGE 30, 227, 241 *et seq*.

968 Assuming that Effective and Efficient Unbundling and an ISO model without investment decision and commissioning powers is a justified restriction of Articles 14 and 12 GG, see further *infra*, Article 9(1) GG (which is merely ancillary to Articles 14 and 12 GG in the context given here) can also be restricted, or vice versa, any unbundling measure exceeding the model of an ISO without investment decision power, would also violate Article 9(1) GG.

(*GmbH* and *AG*)[969], which would in particular occur in the context of stricter legal unbundling measures, would be permissible because Article 9(1) GG does not contain a guarantee of the status quo.[970]

4. PRINCIPLE OF EQUALITY, ARTICLE 3(1) GG

The principle of equality as set out in Article 3(1) GG is unlikely to play a role in Germany, at least with respect to further unbundling measures relating to energy transmission networks. It may become relevant at energy distribution level if Germany allowed such networks which are owned by municipalities to be transferred to a local government department different from the department, which is responsible for the remainder of the vertically integrated energy supply undertaking. In such a case, the discussions concerning the equity principle in chapter 7 on the European Union are relevant by analogy.

V. APPLICATION TO FURTHER UNBUNDLING MEASURES

In this section, only the September 2007 ownership unbundling and ("deep") ISO proposals of the Commission (as outlined in the Introduction) will be discussed as regards their compatibility with German constitutional law, in particular with Article 14 GG. As these Directives give choices, this section will discuss which alternatives can live up to German fundamental rights standards. The alternative proposal put forward by, inter alia, Germany, Austria and France, i.e. the so-called *Effective and Efficient Unbundling*, which also features the current draft Directives agreed in October 2008 and which promotes more stringent legal unbundling measures[971], will be briefly examined at the end of this section but without an in-depth analysis as it is unlikely to raise severe constitutional problems in

969 These two types of companies are the predominant way of organizing energy supply activities in Germany, see Volz, n. 670.

970 See Scholz in Maunz/Dürig, n. 790, Article 9, no. 69; Höfling in Sachs,*GG – Kommentar*, 3rd ed., 2003, Article 9, nos 36–7. The constitutional validity of such measures only becomes questionable where they interfere with the principles of autonomous organization (*Grundsatz der privatautonomen Organisation*) and free self-determination (*Grundsatz der freiheitlichen Selbstbestimmung*), which guarantee free incorporation and organisational operational capability (*Funktionsfähigkeit*), see *ibid*. See also BVerfGE 50, 290, 353 *et seq*. – *Mitbestimmung*. The BVerfG sees shareholdings being primarily protected, and the law related to public limited companies (AG) primarily determined, by Article 14 GG rather than by Article 9(1) GG. See also Papier in Maunz/Dürig, n. 790, Article 14, no. 196, as regards the protection of the operational capability of undertakings by Article 14 GG.

971 For a basic outline, see Introduction.

Germany.[972] More stringent legal and operational unbundling rules, such as the above mentioned alternative proposal, are likely to be considered a legitimate regulation (*Inhalts- und Schrankenbestimmung*) or reorganization of the ownership of energy networks, which do not (even) require compensation. Similarly, the ISO model as applied in Great Britain[973] will only play a role here when showing what is still possible in Germany in terms of compliance with German constitutional law, because such a further unbundling measure even if it included the requirement to transfer the ownership of network assets to the vertically integrated network operation company would be unlikely to pose too great a challenge to German constitutional law.[974]

1. OWNERSHIP UNBUNDLING INCL. SHARE SPLIT

Ownership Unbundling as the most intrusive form of separation of vertically integrated energy supply undertakings would according to what has been said in section IV only be possible by way of expropriation or, indirectly, through legislation ordering a compulsory sale.[975] It is arguable whether the latter is to be seen as expropriation in terms of Article 14(3) GG or as a mere determination of substance and limitations of ownership. What needs to be considered, however, is

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[972] As regards the (constitutional) legitimacy of the current legal and operational unbundling legislation, see Schmidt-Preuß, n. 539, who, however, emphasizes that these provisions test the limits of constitutionality, which seems rather exaggerated.

[973] And thus be explained in greater detail in chapter 5 on Great Britain. In Great Britain, the two vertically integrated Scottish electricity supply undertakings have retained their investment decision powers albeit in coordination and under dispute resolution before the sector-specific regulator OFGEM (in case of conflict with the plans of the national electricity network operator NationalGrid).

[974] In Germany, this transfer has already been executed by the four vertically integrated electricity supply undertakings E.ON, RWE, Vattenfall and EnBW operating the transmission networks. More generally, the transfer of network ownership onto the vertically integrated network operation company would support more stringent operational unbundling by preventing even more effectively undue influence and potential abuse when setting the lease rates (*Pachtzins*), which, by the way, is already reviewed by the German regulatory authority BNetzA.

[975] In the case of expropriation, the good so expropriated does not necessarily have to be at the disposal of the State resp. does not necessarily have to be used by the State in order to fulfil the public task defined by the State as the basis for acquiring (i.e. expropriating) the good in the general interest. The public task would be the introduction and promotion of competition in the sector, safeguarding non-discriminatory TPA etc. The State can also, what is likely to be the case in the context given, have this public task be pursued by private parties, see Papier in Maunz/Dürig, n. 790, Article 14, nos 578, 582, as long as the purpose of the private undertaking, which receives the expropriated good, can be counted towards the generally accepted services of generally (economic) interest, such as energy supply undertakings, and as long as the State ensures that the public task is pursued diligently, see BVerfGE 74, 264, 285 – *Boxberg*.

that the network owner[976] would although disposing of its property itself (i.e. not by way of an act of expropriation) still be forced to completely give up the ownership (whether direct or through shareholding) of its networks. Although this does not, at first sight, look like an outright expropriation or an acquisition of a good (i.e. a network) based on a (direct) sovereign act by the State in order to accomplish a public task in the general interest, the depriving act, i.e. the sale of the shareholding in the undertaking which owns and operates the network is the result of a sovereign act, i.e. the legislative order to sell, which in itself is the performance of the public task of introducing and promoting competition in the energy sector. Hence, it is argued here that this can also be seen as an expropriation[977], a view, which seems to be confirmed by the BVerfG when it states that an "expropriation is directed at the deprivation of specific subjective legal rights guaranteed by Article 14 subs. 1 1st sentence GG *in order to fulfil* certain public tasks (*cf.* BVerfGE 79, 174 <191>; 104, 1 <9>) [emphasis added]."[978] Here also, the BVerfG explicitly speaks about the act of deprivation, which fulfils a public task.

Consequently, as ownership unbundling is in fact to be characterized as expropriation, it would only be allowed if it is in the general interest and if proportionality has been observed. The general interest or the rationale and objectives behind the economic regulation of energy supply networks has been outlined in Part 1 Chapter 1 above; all or most of these objectives are also valid in the German context. Moreover, as has also already been said, European integration and thus the general interest of the European Union is also in the general interest of Germany, which Article 23 GG confirms.[979] In particular the safeguarding of competition is a general interest[980], which is central to the free and social economic order of Germany (*soziale Markwirtschaft*), which is based on the market as an essential mechanism for the operation of this order. Monopolies in general and thus also vertically integrated energy network monopolies in particular can substantially impede competition in energy supply. In this regard, the legislature has changed its view as regards the role competition should play in the sector, i.e. that a secure, affordable and sustainable energy supply cannot be achieved through a system of closed energy supply areas, which

976 Albeit network owner can currently mean a vertically integrated energy supply undertaking not necessarily being the undertaking operating the network, it is assumed here that the network property has already been transferred to the network operating undertaking so that a compulsory sale would concern the shares the parent undertaking is holding in the network owning network operation undertaking.

977 In this respect also Schmidt-Preuß, n. 539, p. 47, no. 32.

978 BVerfG, 26 July 2005, 1 BvR 782/94, 957/96.

979 See in this respect also Article 10 EC. See also n. 543 and accompanying text.

980 See n. 876.

are characterized by protected monopolies, but only through promoting competition in the energy supply sector. In this regard, the legislature has the ability to develop its view over time, a so-called "prerogative of appreciation" (*Einschätzungsprärogative*).[981] The fact that the safeguarding of competition is of general interest can also be derived from the federal legislative competence in Article 74(1) no. 16 GG to prevent the abuse of dominant positions.

In terms of proportionality of such a measure[982], ownership unbundling must be suitable to achieve its aims[983], which are primarily the promotion of competition in energy supply in order to establish a true internal energy market, mainly for the benefit of consumers, but also for energy supply security. When it comes to the suitability of a measure for achieving the ends aimed at, the legislature has a wide margin of appreciation because of the difficulties in arriving at the right prognosis (see more extensively, section IV(1)(b) and (c)). Only evidently unsuitable measures or measures, which interfere with ownership rights such that they do not serve to achieve what is aimed at, cannot be regarded as reasonable.[984] Further, in order for the legislator to judge the effectiveness of the measures envisaged, it should also consider the experiences made abroad with such measures.[985] As a model for ownership unbundling of electricity and gas transmission networks, the experiences made in England and Wales are often referred to. However, as analysed in much greater detail below, electricity transmission in England and Wales was restructured before privatization.

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981 See Papier, n. 770, p. 219.

982 The act of expropriation must be suitable for the achievement of the public task intended to be achieved by the relevant measure, in addition the act must be unavoidable or *ultima ratio* for the achievement of the intended purpose (necessity principle), and the act of expropriation must be proportionate, i.e. means and ends must not be disproportionate. The expropriation is thus not permissible if the damage caused by the act is in its severeness and its magnitude out of proportion to the benefit of the act for the general interest. See, in greater detail, Papier in Maunz/Dürig, n. 790, Article 14, nos 589, 590. See also the elaborations in section IV(1)(b) and (c).

983 See Part 1 Chapter 1. See also, in overview, the 2007 *Sondergutachten* of the German Monopolkommission, n. 646, p. 230, no. 606. However, the German Competition Commission also gives concise insights into why ownership unbundling might not be too ideal to remedy the problems persisting in the energy markets. More particularly, the Competition Commission questions the suitability of ownership unbundling for resolving the high concentration in electricity generation, particularly in Germany, and sees the incentives to invest for network operators and owners and operators and owners of generation capacity endangered by this measure, see only *ibid*., nos 607 *et seq*.

984 See BVerfGE 21, 150, 155; 50, 290, 340 *et seq*.; 52, 1, 29 *et seq*.; 58, 137, 148. It has, however, already been claimed *supra* that the legislature must endeavour to obtain a thorough knowledge of the consequence of the measures they are intending to implement, which in the current context also means that they have to conduct a thorough social cost benefit analysis of such measures. Only if such an analysis is tentatively positive can the legislator regard such measures as suitable to achieve the ends aimed at. See section IV(1)(c) *supra*.

985 See BVerfGE 50, 290, 334.

Evidence of the consequences of this sort of "ownership unbundling" has been requested by the *Bundesnetzagentur* but, to the knowledge of the author, has to date not been received.[986] The voluntary break-up of British Gas, which was initially privatized in a vertically integrated form, has also been extensively criticized from an economic point of view.[987]

In any event, at the latest when considering whether there is a necessity for ownership unbundling, it becomes clear that there are indeed less intrusive *and* equally effective alternatives available, which will be discussed in subsection 2 below.

But even if one agrees with the necessity for ownership unbundling, after what has already been said in Part 1 Chapter 2 on its proportionality, the question of the compensation becomes relevant, in that Article 14(3) 2nd sentence contains the so-called *Junktim-Klausel*, according to which an expropriation can only be legitimate if the law ordering the expropriation also contains details of the form and extent of the compensation to be paid. Normally, the market value must be paid[988], or, if one follows the assumption that compulsory sale is also an expropriation, the difference between what is actually paid for the expropriated good and its true market value must be paid. As it is unlikely that there are too many buyers for energy networks on the market or, to put it differently, as buyers know that these network must be sold, it is likely that the price to be achieved by the seller will be comparatively low or, in other words, the deficit to their market value will be rather high.[989] The circumstances under which compensation is to be paid by the European Community will be discussed in chapter 7 below.

One might, however, disagree with the proposition that compulsory sale is to be seen as expropriation, but see it instead as a deprivation of an existing legal position, which is intended to be an adjustment of private interests (in the same sense that, for instance, third parties not owning networks require non-

986 See K Bourwieg in his presentation 'Bestandsaufnahme und Ausblick zur Entflechtung in Deutschland' in Brussels on 17 September 2007. See also the recent independent study by AT Kearney, n. 323, which concludes that the Commission's claim that ownership unbundling leads to more competition cannot be empirically proven (study was conducted with a view to the European electricity markets).

987 See SERIS, nn. 38, 1213.

988 See BVerfGE 58, 137, 149; 100, 226, 245. Papier in Maunz/Dürig, n. 790, Article 14, no. 609, is more restrictive as to the amount of compensation to be paid.

989 See also Schmidt-Preuß, n. 539, p. 48, no. 35, arguing that in the case of compulsory sale, the stock exchange value of the network undertaking cannot be the measure because it is likely to decrease as the bargaining advantages are on the (potential) buyers' side so that only a valuation by independent accountants would enable the determination of an adequate compensation. More generally, the market value is determined according to generally accepted accounting standards, see in this respect also ECtHR, n. 1515.

discriminatory TPA), or, in other words, as a regulation or determination of the substance and limitations of ownership.[990] Even then, such a measure would not

[990] As to the regulation of ownership, see again, BVerfGE 101, 239, 259; 104, 1, 10. Some basic observations seem appropriate here as regards the proportionality of determinations of the substance and the limitations of ownership by way of granting TPA. In this regard, one has to come back to the general formula that limitations of property rights can be more extensive the more the exercise of ownership rights is bound up with general interest considerations. Such situation results from the natural monopoly character of such *infra*structure. Consequently, parties not owning energy supply networks are significantly dependent on its use. Thus, in principle, limitations on the owner's power to dispose of free network capacity, such as the introduction of TPA, which is supported by unbundling measures, are proportionate as long as the owner's own capacity needs enjoy priority in situations of capacity restraints (shoratges) and as long as this does not endanger the existence of the undertaking owning the network. Similar Papier in Maunz/Dürig, n. 790, Article 14, no. 521. This seems not to be observed sufficiently in situations where the owner is to be treated equally (i.e. without enjoying priority in the case of capacity restraints) to other parties requiring access to its network, such as is the case when an ISO is introduced. The network owner's own capacity does not in principle have to be reduced in order to create more capacity for competitors, see *ibid.* Only if the network owner has "lost" customers so that there is less need for capacity, have capacities to be freed for competitors, i.e. capacity hoarding is not permissible. This results from the fact that Article 14 GG does not protect a aprticular level of sales or market share. These are comments prominently made by an incumbent judge of the BVerfG, before the current legislation entered into force. On the other hand, the nature of network *infra*structure property is peculiar in several respects, which *in principle* also justifies equal access for third/all parties: first, the construction and extension of network *infra*structure can only work by also using the property of third parties and with it at least the threat or possibility of expropriation (see already section IV(1)(d)). Because expropriation is only possible subject to the requirements of Article 14(3) GG (in particular general interest requirements), it must be ensured that network *infra*structure, which has only been able to be construed partly as a result of the expropriation powers of the *infra*structure project undertaking, also serves the general interest (and not only the private interest). See BVerfGE 129, 264, 286 *et seq.* – *Boxberg*. Third Party Access (TPA) can thus also be seen as the use of *infra*structure property to further the general interest. Granting TPA can be seen as being based on the State's particular (residual) responsibility to guarantee the provision of (network) *infra*structure. This does not mean, however, that network property is not in principle worthy of protection. In relation to this discussion, see already section IV(1)(d). What it means is that the scope for the legislator to regulate is wider with respect to ownership limitation in the general interest. In such circumstances, the network owner must accept as a minimum those limitations which safeguard the interests of the general public by ensuring that these are not threatened by the owner's behaviour. See BVerfGE 21, 150, 158 *et seq.*, which, however, concerned state aid; see also, more generally, D Ehlers, 'Eigentumsschutz, Sozialbindung und Enteignung bei der Nutzung von Boden und Umwelt', (1992) VVDStRL 211. A further tool for protecting the interest of the general public is obviously competition law enforcement, in particular s. 19(4) no. 4 GWB. However, the private enjoyment of rights in network *infra*structure property by the owner, which can be regarded as generally subject to limitations but which cannot simply be abolished, is only safeguarded if the network owner receives an adequate consideration for the use of its property by third parties. For a similar view, Fehling, n. 910, p. 92, with further references, and Storr, n. 35. However, what also needs to be considered with respect to the private enjoyment by the owner of rights in network *infra*structure property is that network owners are normally corporate entities. Thus, the concern for "personal" freedom particularly protected by Article 14 GG is to a lesser extent relevant here. Property in the current context does not serve an individual's personal requirements but corporate profit maximization. See also Storr, n. 35. Further, the magnitude

lose its character of being a depreciation of the complete property, i.e. not just a re-determination of the right of property, which the legislator is allowed to pursue. As has already been shown above, the BVerfG has indeed decided that an interference with the right to property can be a mere regulation of ownership even if in its effects it comes close to or is similar to an expropriation.[991] A regulation, however, which can ultimately be considered to be a circumvention of Article 14(3) GG, is constitutionally not permissible so that the objective of such a (State) measure can (then) only be achieved by way of expropriation.[992]

Share split

From the point of view of energy supply undertakings, the above analysis also applies to the unbundling option of a share split. From the point of view of shareholders, a share split would, on the face of it, be a mere redefinition of their

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of interference with the right to property requires the legislator to rectify any malfunctions of an ISO model, which may occur should it be introduced. The latter is another important reason why outright ownership unbundling can hardly ever be regarded as lawful: any rectifications or even reversal are simply not possible. For reasons of legal certainty and the protection of investment as part of the right to property, there must be a transitional period which enables the network owner to honour existing supply obligations (see Fehling, *ibid.*, 93) similar to those provided for in the 2003 Gas Directive; in this respect see also Badura, n. 959. A further aspect of the special social function of network property is that the relevant private interests have to be balanced amongst each other. Consequently, the limitations on network ownership which are associated with equal TPA have to be balanced against the protected fundamental rights of third parties (such as the freedom of economic activity according to Article 12(1) GG) who do not own a network but who require network access. Although the freedom of occupation and economic activity according to Article 12(1) GG or the right to property according to Article 14 GG do not give third parties requesting network access a claim against the State to expand their sales markets or to reuire the State to legislate for it (Papier, n. 770, p. 218), it must be taken into account that the State previously excluded competition in energy supply (see already above). Changing this by allowing competition in energy supply means that restrictions to the fundamental rights of third parties (who have been kept out of energy supply by restricting competition over the years) are now reduced or even removed altogether. Papier, *ibid.*, p. 219. Since the legislature is removing the exemption of energy supply from competition and liberalizing the market as a consequence of a paradigm change in the appreciation of the role of competition in furthering the general interest in a secure, low-priced and sustainable energy supply (or, in other words, since the legislature assumes that the general interest is best served by more competition (including the promotion of an internal energy market) rather than exempting energy supply from competition) it is not only entitled to reduce or rectify existing fundamental rights restrictions but actually obliged to do so for reasons of proportionality or, more specifically, because of the prohibition on excessive measures (*Übermaßverbot*). Facilitating TPA and the unrestricted construction of energy networks thus is an indispensable prerequisite for the achievement of the aim of creating competition in energy supply, and ultimately dictated by the principle of proportionality. Papier, *ibid.*, p. 219.

991 See BVerfG in re *Denkmalschutz*, n. 551.

992 BVerfGE 100, 226, 243. For the national implementation of ownership unbundling, it is questionable whether legislating for a compulsory sale would be permissible at all, or whether the only way open to the legislator is to formally legislate for expropriation.

property (in the guise of a determination of substance and limitations)[993], at least as long as their overall shareholdings and their value remain unchanged.[994] Should, however, one of the two resulting shareholdings have to be sold (because the other shareholding controls either the network or the remaining energy supply activities), then this is likely, at the least, to be a determination of substance and limitation, to which the analysis of the issue of compulsory sale in the previous paragraph can also be applied.[995]

2. "DEEP" INDEPENDENT SYSTEM OPERATOR

"Deep" Independent System Operation as proposed by the Commission is also a suitable means to achieve the objectives sought. This unbundling measure also seems to be an equally effective but less intrusive means[996], which, contrary to the

993 It has been established in section IV that both energy supply undertakings *and* the parent companies of (currently legally unbundled) transmission system operators (despite municipal minority or dispersed public shareholdings in individual cases) enjoy property rights protection in Germany.

994 Dutch municipalities are currently facing a similar situation: there, separate electricity and gas *distribution* network operators have to be in place from 2011, seaprated from the vertically integrated energy supply undertakings, which are exclusively in municipal ownership. These new distribution system operators are to be directly controlled by the municipal owners of the remaining energy supply holdings (which after the separation are only left with production, retail and other competitive energy supply activities). See in greater detail chapter 6 on the Netherlands.

995 The forced sale of shares and company capital only up to a certain shareholding threshold caves into the share ownership to such an extent that the core of the right to property, its private utility (*Privatnützigkeit*), is *de facto* no longer existent. Similar J Kühling, G Hermeier, 'Eigentumsrechtliche Leitplanken eines Ownership-Unbundlings in der Energiewirtschaft', (2008) 1/2 et 134.

996 The German Competition Commission (*Monopolkommission*), which favours independent system operation, regards this alternative as "almost" as effective as full ownership unbundling. This refers, however, to the effective promotion of competition. With respect to safeguarding supply security, which is as important a goal of European energy policy as the promotion of competition, a well designed independent system operator model, however, should not entail the uncertainties of full ownership unbundling with respect to negative incentives to invest into network as well as generation capacity, see the 2007 *Sondergutachten* of the German Monopolkommission, n. 646, pp. 230 *et seq.*, and G Brunekreeft, J Gabriel, D Balmert, *Independent System Operators – ein Überblick*, Gutachten, bremer energie institut, Bremen, 3 May 2007. But see also n. 130 as regards the so-called strategic investment withholding argument used by the Commission in its sector inquiry in order to push its ownership unbundling plans. See also the notes in Part 1 Chapter 2 referring in the context of the proportionality assessment, which refer to Haucap (n. 38). The introduction of independent system operation, however, requires careful designing, in order to realize its full effectiveness and economic efficiency, but more importantly, to avoid incurring compensation obligations. See Brunekreeft *et al.*, *ibid*.

claim of the Commission, would also not involve so much more regulatory cost.[997]

Generally, the ISO model has significant advantages over full ownership unbundling. It seeks a balance between two goals, which is the promotion of non-discriminatory competition on the one hand, and the reconciliation and coordination of the different levels of production (system operation and transmission network ownership) on the other, and because generation and networks remain in one set of hands, possible "spill-overs" (as economists call overlapping and thus superfluous investments) are internalized or can be prevented because both stages of production remain vertically integrated.[998]

To give up network operation and leave it to an independent TSO regulates or determines the substance of network ownership because the network owner would not be able to make full use of its property any longer; the forced surrender of network operation could not be classified as an outright expropriation because the network owner would be able to retain its network property.

The ISO model is another significant restriction of the property rights of the network owner after the only relatively recent introduction of regulated network access secured by legal and operational unbundling; the use of network property for private purposes (*Privatnützigkeit*) would ultimately be reduced to a mere monetary consideration for putting the property at the disposal of independent

997 See Frontier Economics, 'Further unbundling in European energy markets', Energy briefing, Regulation & Unbundling, February 2007, according to which it is not clear why the separation of individual activities into two organisations (which can both be financially incentivized by way of regulation) would result in a need for more regulation of the individual activities than if they were combined in one organisation. If not incentivized, splitting activities across two organisations would lead to placing significant reliance on the contract between them. This contract would have to replicate the incentives internalised within a TSO owning the networks. This would indeed lead to a need for significantly greater regulation and thus an increased regulatory burden. Frontier Economics, however, argues that because of the individual interests of either activity to achieve an efficient outcome, the additional regulation, which would induce the two activities to achieve such an efficient outcome by financially incentivizing them, would be limited in scope. See also Part 1 Chapter 2 *supra*.

998 Brunekreeft *et al.*, n. 996. Both options, ownership unbundling and independent system operation, indeed have the advantage that networks can moer easily be interconnected across transmission system zones, which for Germany would mean easier control over the four transmission zones existing there, but in the medium-term also cross-border, which would enhance the European-wide interconnected energy *infra*structure, and help to reduce congestions on the interconnectors. See the 2007 *Sondergutachten* of the German Monopolkommission, n. 646, pp. 230 *et seq.* See also the discussion in Part 1 Chapter 3 in this regard.

network operators[999], which will be determined by the sector regulator.[1000] Depending on the extent of powers an ISO can exercise, the owner also loses the control over its property and power to dispose of it freely (apart from obviously selling it). Although the network owner can still receive income from its network property and decide whether to sell it, the owner can no longer make decisions about the use of the network and the admission of certain users to it.

In the context of what has been just said, should the plans of the Commission become reality (which appears will be the case according to the draft Directives of October 2008, albeit as one option amongst three in total), conferring the investment decision and commissioning (i.e. by way of tendering) powers to an ISO[1001] to benefit all access seekers (by way of TPA) would downgrade network owners to simple investors in their own grids (without even the ability to decide whether they want to invest) while also being service providers to, and maintaining and rendering technical services for, such grids.

All of this can be seen as a side effect of a reorganization of energy supply which will have an effect for the future.[1002] For such a *re*-determination of ownership, the legislator in principle possesses a wide margin of appreciation as regards the ends it wants to achieve[1003], which, however, is not unlimited. Such a limitation would, for instance, be reached with the introduction of a duty for the network owners to invest in order to fulfil access demands by third parties (or with allowing third parties to tender for investment)[1004], as this is widely seen as

999 See also Storr, n. 35, p. 236.

1000 Already before and shortly after the second energy package was released in 2003, it was claimed that the restrictions such a regulatory measure imposed on the right to property would be very close to the borderline of what was constitutionally allowed. See, for instance, M Schmidt-Preuß, 'Verfassungskonflikt um die Durchleitung? – Zum Streitstand nach dem VNG-Beschluß des BGH', (1996) RdE 1; U Büdenbender, 'Durchleitungen in der Elektrizitätswirtschaft und Eigentumsschutz', (2000) WuW 119; Badura, n. 959; H-J Papier, *Die Regelung von Durchleitungsrechten*, 1997, pp. 13 *et seq*., and in Maunz/Dürig, n. 790, Article 14, no. 521 with further references.

1001 It is characteristic of ISO models that tensions arise between the power to operate the networks and the financial risk, which are to a large extent in different hands. Accordingly, if an ISO is competent to decide about investments, there is a separation between the decision maker and the bearer of the risk who is held responsible and financially liable if the investment was a commercially flawed decision. The core problem is that intentionally an ISO does not possess any major assets, which would put it in a position to cover failed investments out of its own pocket. See in greater detail, Brunekreeft *et al*., n. 996.

1002 See Haslinger, n. 35, p. 344, with further references.

1003 BVerfGE 83, 201, 212. As regards the means, the proportionality principle must be obeyed.

1004 See the extensive discussion on TPA in n. 990.

incompatible with the guarantee of the right to property, which also includes the "negative" freedom *not* to invest.[1005]

It is thus submitted that the investment decision and commissioning powers of ISOs as proposed by the Commission would also be incompatible with fundamental rights because if the powers of the network owners to use or dispose are restricted in such a massive way so that only an "empty shell" of the right to property remains[1006], a complete devaluation of the right to property is the consequence and would thus be equal to a depreciation of property which would entail similar strict justification requirements to an expropriation[1007] (i.e. a general interest justification, the observance of proportionality and the provision of compensation (see above) would be required).[1008]

1005 Papier, n. 770, p. 22 with further references. Such investment duties should be distinguished from what is already a fact today: in the course of performing services of general economic interest, network operators have the basic duty to maintain and reinforce energy networks in order to contribute their share to secure and reliable energy supply (for German law, see ss. 12 *et seq*., 17 *et seq.* EnWG). Further, they have the general duty to connect except where there are technical and economical reasons, i.e., for instance if there is a capacity restraint. The latter duty is, furthermore, reinforced by the very recent implementation of the KraftNAV, see nn. 660 and 716, n. 1011 and Part 1 Chapter 2 *supra*. See also Höppner, n. 617. It is the aim of this regulation to facilitate new generation projects, thereby reinforcing competition. The connection can only be refused if the point of connection does not fulfil the technical requirements for the feeding-in of electricity. The network operator must undertake all measures necessary to establish the technical requirements, which include the reinforcement of the grid to the next network hub. Possible capacity restraints must not lead to the refusal to connect. The party to be connected must bear the costs of connection and any necessary works to establish the technical requirements for connection including the reinforcement of the grid up to the next network hub (so-called shallow connection charges) if the connection is exclusively used by this party and if the equipment does not become the property of the network operator. In case of capacity restraints, new generation plants have to have priority access to the grid, which is supposed to promote the modernization of the global generation plant assets and competition. Apart from these regulatory requirements, network access can also be ordered by applying s. 19(4) no. 4 GWB (see *supra*) in cases where the network operator abuses its dominant position.

1006 The requirement to use private property to further the general interest is not allowed to result in an excessive burden or violate the owner's proprietary sphere unreasonably, see BVerfGE 21, 150, 155; 50, 290, 340; 52, 1, 29, 32; 53, 257, 292; 58, 137, 148.

1007 BVerfG in re *Denkmalschutz*, n. 551, already discussed *supra*.

1008 In this respect also Badura, n. 959. In the context of the freedom of occupation and economic activity protected by Article 12(1) GG, see section IV(2), the unbundling provisions regulate the modalities of entrepreneurial activity and the exercise of an occupation. From this it also follows that should an ISO model in whatever form be introduced, vertically integrated energy supply undertakings, which are network owners, are not allowed to operate as network operators any more. More detailed on the question of whether network operation is a protected occupation, see Haslinger, n. 35, p. 347 *et seq.* The prohibition on such undertakings pursuing network operation is an objective restriction of the free choice of an occupation (*objective Berufszulassungs-* or *Berufswahlbeschränkung*) because to allow a person to become a network operator does not depend on the personal characteristics of a network operator or any personal conditions a network operator has to fulfil but rather on objective criteria, which do not relate

From a legal point of view, it is indeed claimed that there exist even less intrusive means than the introduction of an ISO model, such as more stringent legal and operational unbundling.[1009] Economists, however, suggest the necessity of independent system operations outside vertically integrated structures.[1010] And although several economists demand full ownership unbundling, this is usually a broad brush claim on a theoretical basis made without even looking into the empirical foundations of such a claim. As soon as they obtain empirical evidence or gain specific insights into the functioning of particular national energy sectors, this picture changes, tentatively favouring non-vertically integrated independent system operation.[1011]

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to the person of a network operator. See Haslinger, n. 35, p. 348 with further references. This is because one is generally free to choose and exercise an occupation but as soon as the choice is made, choosing a certain other occupation is not possible any more. See *ibid.* Such objective restrictions are only permissible if they are absolutely necessary in order to avoid a threat to an outstandingly important common good, which is both evident and the damage frlowing from it is highly likely, BVerfGE 102, 197, 214. As this objective restriction does not concern the choice of the first occupation but merely the second occupation (i.e. either being a network operator who then wants to become active in competitive up- and downstream energy supply activities or being a vertically integrated energy supply undertaking active in competitive up- and downstream activities which then wants to become a network operator), this restriction is easier to justify, *cf.* BVerfGE 21, 173, 181. The proportionality of such a restriction must be weighed against the importance of the common good, i.e. low-priced, secure and country-wide supply of energy, to be safeguarded by this restriction, see BVerfGE 54, 301, 331. As Articles 12 and 14 GG are normally subject to essentially the same limitations, BVerfGE 50, 290, 364, the proportionality aspects discussed in the context of the possible introduction of an ISO model are also applicable here. See also Papier, n. 770, p. 223.

1009 See, e.g., Säcker, nn. 30, 682. This is indeed a less intrusive alternative but considerably less effective as it does not sever the ties between network operation and the vertically integrated energy supply undertaking with all the conflicts of interests and problems this entails and which have been identified by the vast majority of economists. See also the elaboration on *Effective and Efficient Unbundling infra*.

1010 According to the 2007 *Sondergutachten* of the German Monopolkommission, n. 646, the introduction of an ISO model would indeed sufficiently sever the influence a vertically integrated energy supply undertaking, which is network owner, could have on the up- and downstream markets.

1011 See also the extensive discussion in Part 1 Chapter 2 *supra*. With regard to the plans of the Commission as applied to the circumstances in Germany, see the 2007 *Sondergutachten* of the German Monopolkommission, n. 646, and Brunekreeft, n. 9, who has just carried out a social cost benefit analysis with regard to the competition effects of ownership unbundling in Germany, and discovered that the competition effects of ownership unbundling are rather small on the assumption that generation capacity remains stable in the medium- and long-term. Although nuclear energy is being reduced in Germany and capacity mothballed (5 GW in total), the new Regulation regulating the connection of new generation capacity, KraftNAV, see nn 660, 716, 1005 and Part 1 Chapter 2, appears to be an effective tool to promote independent generation capacity, i.e. capacity not build by incumbents. The conclusion that ownership unbundling does not have too great an effect (if any) on the promotion of competition on the European electricity markets is confirmed by the independent study of AT Kearney, n. 323.

Having said that conferring investment decision and commissioning competence on an ISO would be a regulation of property which amounts to an expropriation, and also in view of the indications in particular in economic literature that such additional powers would not be conducive[1012] to achieving the objectives sought[1013], the thrust of the argument is turned around here to claim that only an ISO model without such wide-ranging powers would be admissible under German constitutional law. Such an ISO model, it is claimed here, would be the maximum of what complies with the principle of proportionality. As it is crucial for an ISO model (without such wide-ranging powers) to function effectively and efficiently, the corporate governance issue comes to the fore. Economists have already identified the investment issue as the "Achilles heel" of ISO models.[1014]

A solution in conformity with German constitutional law could be the implementation of an ISO model in Germany along the lines of what is current practice in the Scottish market.

In summary[1015], in Scotland an entirely independent TSO (NationalGrid) exists, which operates the Scottish electricity transmission networks and which is responsible for balancing the grids, for taking precautions against black-outs, for entering into connection and access agreements with network users, and for coordinating the investment planning which is also carried out by the two vertically integrated Scottish transmission network owners. The latter put their networks at the disposal of the TSO but remain responsible, in parallel with the TSO, for the planning, the development and the maintenance of the network in their network zone; they also provide transmission network services to the TSO. The TSO determines and invoices the network access charges regulated by the sector regulator OFGEM. The Scottish transmission owners (TO) determine their own charges which are invoiced to the TSO, which are also regulated by

1012 More details in Part 1 Chapter 2, in particular in the context of the analysis rendered by Haucap.

1013 See Part 1 Chapter 1 *supra*.

1014 Brunekreeft *et al.*, n. 996, which tend towards a club ownership structure when pleading for the participation of market actors in the ISO. Accordingly, club ownership would deal with the typical ISO tension arising between the competence to operate the networks and the financial risk, which are to a large extent in different hands (i.e. the independence of the ISO can conflict with the the interests of the party who has to bear the risk for network investments), by involving the bearer of the investment risk, albeit with only a little influence. Indirectly, all stakeholders are represented in a club ownership solution: generators, transmission owners, suppliers, traders and customers. All participants (including any associated or affiliated undertakings) entitled to vote would have the same voting right no matter how big they are, i.e. according to the principle: *one party, one vote*. The board of executive directors would consist of independent members, whose primary task it would be to select and supervise the managers of the ISO, and to approve the budget.

1015 More details are to be found in the next chapter on Great Britain.

OFGEM and which include the charges for the TSO using the Scottish networks and for maintenance and investments provided by the TOs. The TSO does not have the competence to demand investments from the TOs. Should, however, the TOs not comply with an application of the TSO to invest, then the dispute is resolved by OFGEM.

Translated to the situation in Germany, the implementation of an ISO model comparable to the Scottish would mean that the then (four) German TOs and one independent TSO would all five plan the investments they deem necessary. In the case of conflict, the BNetzA would be competent to resolve such conflicts.[1016] This would happen on the basis of BNetzA's competition law powers with regard to network access issues (see above), i.e. checking whether the refusal of a TO to comply with an investment request of the TSO is an abuse of a dominant position in that the TO prevents competitors from entering the market or endeavour to keep them out of its supply area in order to shelter its up- and downstream businesses from competition.[1017]

The distinguishing element in Germany compared to the UK could be that in Germany, the party "losing" such a dispute resolution would be able to appeal to the competent courts (in the UK, dispute determinations by OFGEM are normally final without an opportunity for appeal).

1016 The regulator, which secures the refinancing of the investment via approving the network charges, thus becomes part of the negotiation process. It is one of its predominant tasks, however, not to endanger the existence of the undertaking owning the networks. The regulator thus steps into the shoes of the undertaking owning the network (operating) undertaking, which is at least under the current scenario able to determine the global indebtedness limits and the annual financial plans of the network operator.

1017 This is also one of the most important arguments in the unbundling debate, also known *strategic investment withholding*, see n. 130. This assumption is also the basis for the argument followed in the energy sector inquiry, and which is also a dilemma in ISO models (i.e. the lack of investment incentives which is also an important argument against the enforcement of ownership unbundling though; see only the 2007 *Sondergutachten* of the German Monopolkommission, n. 646. This is because if the investment decision is made by the transmission owner and not by the ISO, the investment withholding problem does not go away. On the other hand, should the ISO have investment decision powers without investing itself, then a separation between the decision maker and the risk bearer occurs. Such a separation would be acceptable more easily according to Brunekreeft *et al.*, n. 996, if the TO had influence (albeit a limited one) within the organization of the ISO on the ISO's decision making.

3. *EFFECTIVE AND EFFICIENT UNBUNDLING*

Coming back to the claim that there exist even less intrusive means, which are equally as effective as independent system operation[1018], the draft Directives as agreed on 9 and 10 October 2008 (and approved by the European Parliament) contain an option additional to ownership unbundling and "deep" independent system operation, the so-called Independent Transmission Operator (ITO)[1019], which goes back to a proposal of 29 January 2008 by, inter alia, France and Germany.[1020]

The ITO model allows a vertically integrated energy supply undertaking to retain its energy transmission networks, to operate them as a subsidiary and to consolidate its results thus protecting the financial interest of the vertically integrated undertaking.

The network operation subsidiary would have to be transformed into a limited liability company (not necessarily a public limited company any more) with a separate management and supervisory board.

The TSO subsidiary would have to have all the assets necessary to operate the networks; it must in particular own the networks.[1021]

1018 Which has, however, already been rebutted by economists, see *supra*.

1019 See Recital 12, Articles 9(8), 17 *et seq.* (chapter V) of the draft Energy Directives as agreed by the European Council in October 2008 and approved by the European Parliament in April 2009. See already nn. 31, 33, 94, 372, 426, 569. See also n. 1525.

1020 See nn. 29, 30, 32 and accompanying text. See Säcker, n. 682. The ITO model seems largely to go back to the suggestions made by Säcker.

1021 Requiring that the network assets have to be transferred to the vertically integrated network operating subsidiary (a requirement, which the (four) German electricity TSOs already fulfil) is a (re-) determination of the substance and limitations (or regulation) of ownership, which the legislator is in principle allowed to pursue according to Article 14 (1) 2nd sentence GG without being required to pay compensation. Should one, however, consider such a "shift" to be an expropriation, then according to what has already been said about the general interest requirement, which needs to be fulfilled in order to render an expropriation lawful, the general interest with respect to tighter legal unbundling measures is certainly fulfilled. What is more, compensation is not an issue in this respect either as such compensation would have to be paid by the vertically integrated network operating undertaking receiving the expropriated network assets from its vertically integrated sister (generation or supply) or parent (holding) undertaking, which is thus a measure financially neutral to the vertically integrated energy supply undertaking as a whole. As regards the obligation for the beneficiary of an expropriation to pay compensation, even if such a beneficiary is a natural or legal person, see Papier in Maunz/Dürig, n. 790, Article 14, nos 637 *et seq.*, 638. The re-determination or expropriation, if any, would naturally both have to fulfil (and according to the reasoning followed here, also pass) the proportionality requirement.

The parent undertaking would not have any control over the day-to-day operations of the TSO. The supervisory board of the TSO subsidiary would be competent to approve the annual and longer term financial plans, the level of indebtedness of the TSO and the dividends payable to the shareholders.

As regards the composition of the supervisory board, the ITO option allows for at least half of its members minus one, i.e. the minority, to be exempted from the "professional independence" rules, i.e. more the half of its members can come from the vertically integrated energy supply undertaking.[1022]

The ITO option further requires that the majority of the management of the TSO is not allowed to have worked for the vertically integrated electricity *or* gas supply undertaking within three years before appointment and cannot return to the employment of the vertically integrated company for a period of 4 years after leaving the TSO management (so-called "cooling-off" period).

The ITO option gives the regulator considerably greater powers. In particular these are the power to veto the appointment of members of the supervisory board and management board of the transmission company (TSO) on the grounds of lack of "professional independence", and the ability to levy fines if the TSO fails to comply with the obligations imposed on it as a result of the provisions of the Energy Directives. In case a TSO does not execute an investment specified in its rolling 10-year investment plan, accepted or amended by the national regulator, the regulator can amongst other measures put this investment out to tender, which will then be financed from the regulated tariff.

The ITO model is a stricter enforcement of legal and operational unbundling, which is merely giving the current European Directives more contours; it does not remove the conflict of interest between network operation and production or supply within the vertically integrated company, which might lead in practice to a lack of independence as regards the exercise of decision making rights, which might in theory exist as a result of incorporating the network operation as limited liability company. As this proposal is a less intrusive option in terms of

[1022] As regards the fundamental difference in the perception of professional independence in a corporate governance context in anglo-saxon countries compared to Germany, see B Nagel, 'Unabhängigkeit der Kontrolle im Aufsichtsrat und Verwaltungsrat: Der Konflikt zwischen der deutschen der angelsächsischen Konzeption', (2007) NZG 166; see also F Säcker, 'BB-Forum: Corporate Governance und Europäisches Gesellschaftsrecht – Neue Wege in der Mitbestimmung', (2004) BB 1462. Together with the fact that more than half of the supervisory board members can be associated with the vertically integrated energy supply undertaking, the independence of the supervisory board from the influence of the vertically integrated energy supply undertaking seems more than questionable.

fundamental rights interference than the introduction of an independent system operator model and as the ISO model under certain conditions is likely to pass the fundamental rights test, the ITO model is likely not to violate any fundamental rights.

VI. ARTICLE 56 EC

Article 56 EC would apply to further unbundling measures taken by Germany unilaterally, i.e. not as a result of implementing European legislation, if foreign nationals planned to invest (and/or provide services and/or establish themselves) in the energy supply sector in Germany or are already invested (and/or providing services and/or established) there.[1023] As such a scenario is, however, extremely unlikely to happen in Germany, it suffices to refer to the discussion and conclusions in this regard in chapter 5 on Great Britain, which would in principle be applicable here by analogy.[1024]

VII. CONCLUSIONS

Germany's energy supply sector is characterized by vertically integrated energy supply undertakings, which comply with the current legal and operational energy supply network unbundling requirements of the 2003 Energy Directives. Energy transmission is vertically integrated in private and private public energy supply undertakings whereas energy distribution is characterized by a mix of vertically integrated private, public private and public energy supply undertakings.

A sector regulator, the *Bundesnetzagentur*, only become operational in summer 2005 with regulatory and competition law powers in the area of energy network

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[1023] With regard to the question of the relationship of the freedom of free movement of capital (Article 56 EC) and the freedom of establishment (Articles 43 *et seq.* EC), see n. 571. As has already been said there, only the first is subject to analysis here. If Germany opted for complete ownership unbundling on the basis of European legislation and opting for the introduction of an ISO model was also possible under European legislation and other Member States, undertakings of which are invested or planning to invest in Germany, opted for the latter, Article 56 EC would also be applicable to German legislation because it would according to what is claimed here implement an illegal option, see in this respect the text accompanying n. 557. This is apart from the fact that EC legislation would itself be in breach of Article 56 EC as outlined in Part 1 Chapter 3 section V(4). The situation would be similar to what is going to be established for the UK described in chapter 5. It will, however, be different to what is going to be established for the Netherlands which is described in chapter 6 because of the Dutch State's involvement in the sector.

[1024] The situation in the Netherlands is somewhat different, see n. 1023, and chapter 6 on the Netherlands.

operations, the latter of which it shares with the German competition authorities, in particular the *Bundeskartellamt*. Since the beginning of 2009, the networks have been regulated by way of incentive regulation.[1025] Further, specific legislation is in place to promote and safeguard new generation capacity.

It is against this background, in particular as regards the private (public) structure of energy transmission, which is "only" legally unbundled that the Commission proposals of September 2007 are a cause of great concern. This is exacerbated by a rather elaborate and detailed fundamental rights protection in Germany, which is guaranteed by a Federal Constitutional Court, the *Bundesverfassungsgericht*, and its rather robust stance with respect to fundamental rights protection afforded by the European Union in general and the European Court of Justice in particular (see further in chapter 7 on the European Union). In this context, it is, however, not clear whether public energy supply undertakings and public shareholders of energy supply undertakings would enjoy protection under German constitutional law; it is in fact pleaded here in favour of such protection given the current context.

The introduction of the further unbundling measures of ownership unbundling of energy transmission networks would mean an expropriation of the vertically integrated ESUs concerned (or of their shareholders). It would be likely to be unconstitutional, and the introduction of independent system operation together with adequate network regulation along the lines of what is currently in place in Scotland, i.e. an ISO without investment decision and commissioning powers (see further in chapter 5 on Great Britain), would be a less intrusive but equally effective unbundling measure and probably the furthest stricter unbundling measures could go in Germany.

This result holds even more (at least for electricity) if the recent social cost benefit analysis of *Brunekreeft* is adequately taken into account according to which it is actually sufficient generation that matters and not ownership unbundling of electricity transmission networks whose competition promotion effects in the German electricity market are relatively small (as long as there continues to be sufficient generation capacity in the German market in the medium- and long-term).

It is against this background that the "deep" independent system operator model proposed by the Commission, i.e. an ISO with investment decision and

[1025] As regards the expectations imposed on this regulatory mechanism in Germany, see Brunekreeft/Bauknecht, n. 656.

commissioning powers, which equally amounts to an expropriation of the energy supply undertakings concerned, would also be unconstitutional.

Should the draft Directives of October 2008 enter into force (largely) unamended, these discussions are likely to remain hypothetical for the time being. They would, however, be likely to become relevant again in a few years time when the Commission reviews the success of these new legislative measures. Germany will be likely not to impose more than *Effective and Efficient Unbundling* onto the sector, which is, as has been explained, a form of stricter legal and operational unbundling.

CHAPTER 5
GREAT BRITAIN

I. INTRODUCTION

The UK is the pioneer of energy market liberalization, which by far predates similar efforts by the European Commission. The UK legislation for liberalization predates the corresponding Energy Directives by seven years in the case of electricity[1026] and by twelve years in the case of gas.[1027]

This chapter deals with the most significant constitutional issues arising in the United Kingdom should more intrusive forms of unbundling be introduced, such as proposed by the European Commission. It will, however, be more concise than the discussion on Germany. This is because the transmission ownership structure of the (downstream) gas supply sector of Great Britain[1028] as well as the transmission ownership structure of the electricity supply sector of England and Wales are already ownership unbundled. Electricity transmission in Scotland, on the other hand, albeit still vertically integrated, is independently operated by the electricity transmission owner and operator of England and Wales. Although the Scottish independent system operation model comes close to and has certainly inspired for the current unbundling demands of the European Commission in this area[1029], the Commission proposals would, despite the extensive unbundling already in place in Great Britain, still require further changes to be made.

1026 1996 Electricity Directive vs Electricity Act 1989.

1027 1998 Gas Directive vs Gas Act 1986, which, however, was substantially amended by Gas Act 1995.

1028 While with respect to electricity and gas a uniform regime applies across England, Wales and Scotland (which in the latter case contains some specificities of great interest in the context of this work), whereas Northern Ireland has a separate regime for both electricity and gas which is of no particular interest in the context of this work. Accordingly, only the legal regime for the electricity and gas industry in England, Wales and Scotland (Great Britain) will be looked into here. For information about the legal regime in Northern Ireland, see http://ofreg.nics.gov.uk. For some introductory remarks on Northern Ireland, see Dow, n. 333, nos 15.01, 15.206, and J Bremen, 'The United Kingdom', in P Cameron (ed.), *Legal Aspects of EU Energy Regulation*, OUP, 2005, no. 15.01.

1029 See, for instance, Financial Times, 'Barroso warns on EU energy dominance', 20 November 2006.

First, the evolution, structure and regulation of network-bound energy supply in Great Britain (GB) will be outlined in brief in section II. Because the United Kingdom is a unitary State and municipalities do not play an independent role in energy supply, section III will instead focus on other aspects of the exceptional constitutional setting of the United Kingdom to the extent relevant here. It will predominantly feature the Human Rights Act 1998 (HRA), which entered into force in 2000, and deal with the repercussions of one of the most important characteristics of British constitutional law, the legislative sovereignty of Parliament.

The HRA makes most of the ECHR directly applicable in the United Kingdom[1030] and thus initially open to interpretation by British courts. As the entire energy supply sector in Great Britain is in private corporate hands today, any further unbundling measures would hit private legal persons. Section IV will thus focus on legal theory issues of property right protection (including its relationship to economic activity) against the background of Article 1 of the First Protocol of the ECHR and of the subject of protection of fundamental rights in the current context, in particular whether the shareholders of the legal entities subject to further unbundling measures can claim victim status.

Against the background of the original proposals of the European Commission of 19 September 2007 for third generation Energy Directives[1031], three transmission unbundling issues relevant in Great Britain will be scrutinized in section V as regards their compatibility with the ECHR as applicable in the UK. The first issue is the introduction of complete ownership unbundling of electricity transmission in Scotland, the second issue the introduction of independent electricity system operation in Scotland as demanded by the original Commission proposal and the third issue is what would the legal implications be if the national energy transmission system operator applied for a electricity generation or energy supply licence, which the sector regulator OFGEM would be likely to reject.

Because further unbundling measures would mainly affect the two vertically integrated Scottish energy supply undertakings, Scottish and Southern Energy plc and ScottishPower Ltd (the latter is a subsidiary of the Spanish energy supply undertaking Iberdrola), section VI will focus on possible violations of Article 56 EC, the fundamental freedom of free movement of capital.

Section VII summarizes the findings of this chapter and concludes.

1030 Issues of common law fundamental rights will not be discussed here for reasons outlined where relevant. As regards the relevance of these rights after the introduction of the HRA, see T Allen, *Property and The Human Rights Act 1998*, 2005, p. 16.

1031 N. 15.

II. NETWORK-BOUND ENERGY SUPPLY

In 2004, the UK turned into a marginal net gas importer for the first time after having been self sufficient in gas before. The gas pipeline interconnection with Belgium (Bacton-Zeebrugge)[1032] was thus originally built for the purpose of exporting gas to the European countries on the mainland. Since then, however, this interconnection has become crucial for the future security of gas supply in the UK through imports of gas as has the Langeled pipeline to Norway, which connected the UK to new northern Norwegian fields in 2006.[1033]

As regards electricity, one important feature of the UK, in comparison with Germany, for instance, has been the closure of redundant generation capacity. The UK still has a significant excess of capacity[1034], which has been conducive to the liberalization or creation of competition in the UK electricity market, and which is highly relevant in the context of the later assessment of the proportionality of further unbundling measures as regards electricity transmission in Scotland.[1035]

After privatization in the second half of the 1980s, both sectors including nuclear energy are characterized by an absence of state ownership and control with the only involvement of the state being as energy sector regulator.

1032 There are a further two interconnectors to supply gas to Ireland and Northern Ireland. The principal rights to capacity in this UK-Belgian interconnector are currently held by a total of seventeen parties. Other parties may access the capacity in the interconnector via arrangements with these parties by way of assignment or sub-letting of capacity rights or use of third party shipping services. At both ends of the UK-Belgium gas interconnector, there are gas trading hubs offering the opportunity for arbitrage between the mainland and the UK markets. Bacton is also a major landing point for gas produced from the UK sector of the North Sea, as well as being the entry point for the Langeled pipeline with Norway. Dow, n. 333, no. 15.189. On the Bacton-Balgzand pipeline, see also M Roggenkamp, 'Establishment and Role of the Bacton-Balgzand Pipeline within the Internal Gas Market', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports II*, 2005, chapter 11.

1033 On the Langeled gas pipeline, see A Brautaset, 'The Ormen Lange Field, the Langeled Pipeline and the New UK – Norway Framework Agreement Concerning Cross-Boundary Petroleum Cooperation', in M Roggenkamp, U Hammer (eds), *European Energy Law Reports II*, 2005, chapter 12, pp. 199, 200.

1034 Dow, n. 333, no. 15.12 (note 7).

1035 Although concerned with the electricity sector in Germany, Brunekreeft, n. 9, in his recent social cost benefit analysis considers sufficient generation capacity as an important limiting aspect of the effectiveness of ownership unbundling.

1. EVOLUTION AND STRUCTURE

Energy industries in the UK were started by private companies but became heavily state-controlled and mostly state-owned over time. It was assumed that the state could best serve the public requirement for energy; ownership and control enabled the state to guarantee supply.[1036] As a result, the electricity industry was taken into state ownership, the (downstream) gas supply industry run by the state gas supplier British Gas Cooperation (formerly British Gas Council), which had the monopoly purchase rights (monopsony) over all gas produced in the UK sector of the North Sea.[1037] The State returned its interests to private hands some 20 years ago because it did not deem it necessary any longer to act as the country's energy provider; this privatization involved a simultaneous fundamental restructuring of the electricity supply sector, which will be further outlined in turn.

The only influence the state has on the UK energy sectors is by way of regulation, which ensures that persons other than the government will deliver secure, diverse, and sustainable supplies of energy in the way required and at competitive prices.[1038]

Because the UK was for many years self sufficient in gas and a net gas exporter, it never had to think about security of supply until recently, which put it in a completely different position from many other European countries[1039]; only the Netherlands, Norway and, maybe, France were and still are in a similarly comfortable position.[1040] As a result of the UK turning into a net importer of gas, the government seems to be prepared to play a greater role again in the UK energy sector to ensure security of supply.[1041]

Gas sector privatization was enforced by the Gas Act 1986[1042], which simply moved the former monopolist, the British Gas Corporation, in all stages of

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1036 Dow, n. 333, no. 15.18, which bears some resemblance to the German concept of *Gewährleistungsverantwortung*, see in greater detail chapter 4 on Germany.

1037 Dow, n. 333, no. 15.19.

1038 Dow, n. 333, no. 15.21.

1039 Dow, n. 333, no. 15.24.

1040 If one considers energy from nuclear in France as a comfortable position, which nevertheless still requires the import of nuclear fuels. As regards the Netherlands, the Dutch energy sector has always been largely the domain of the State and its subdivisions, whereas Norway is exceptional in that in its domestic market it uses electricity from hydro but hardly any of its vast gas reserves thus making it a major gas exporter.

1041 Dow, n. 333, no. 15.22. To some extent this reflects the concession that the State does indeed hold a "Gewährleistungsverantwortung" for energy supply, an insight, which continental countries such as Germany and France have never given up.

1042 As substantially amended by the Gas Act 1995.

(downstream) gas supply (including the gas pipelines)[1043] into the private sector as British Gas plc. (BG), a decision, which was fundamentally flawed.[1044] This is because leaving the structure of the gas industry vertically integrated[1045], especially in one single incumbent undertaking without creating a number of new gas supply companies from outset of the liberalization progress, did not at all address the fundamental issue of competition.[1046] The responsibility for the development of competition in the sector was effectively put into the hands of the industry regulator, and it took him about a decade to establish. As a consequence, this way of privatization and liberalization entailed the immense practical cost of delayed competition: the benefits of privatization were not felt in the UK for some years, leaving significant opportunity cost to be borne.[1047]

In GB today, National Grid Gas plc. (NGG – formerly Transco)[1048] is the owner and operator of the National Transmission System (NTS), which transports gas from beach terminals and interconnectors to 12 Local Distribution Zones (LDZs), which are organized as eight regional gas distribution networks, and large industrial customers. The NTS is a high-pressure pipeline system. All except for

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1043 The state monopoly only comprised of onshore gas transmission and distribution inclusive of the supply of gas to consumers.

1044 For an historical account, see Volz, n. 670; for the economic motives behind this move, see Dow, n. 333, no. 15.141; see also SERIS, n. 38, with respect to the claim that even after voluntarily divesting the gas transport pipelines, economic benefits have not occurred.

1045 With legal unbundling of the transportation business being put in place between 1994–1996.

1046 As the monopolist was privatized intact, its private sector successor took over the benefits (contractual entitlements) of the monopsony. Further, BG was the only supplier from the beginning. Because the UK was self sufficient in gas before the interconnector to Belgium became operational, there was simply no gas for anyone else to sell. As a consequence, the sector regulator had to order gas release to competitors. See Dow, n. 333, no. 15.146.

1047 Dow, n. 333, no. 15.143.

1048 National Grid Transco is the (indirect) result of two *voluntary* demergers (ownership unbundling) executed by British Gas plc. in 1997 and 2000: First, in February 1997, the shareholders of British Gas approved the demerger of its legally unbundled suppy function (gas trading company) Centrica plc. (with the trading names British Gas and Scottish Gas) and British Gas was renamed BG plc. mainly consisting of production and gas transportation assets. In October 2000, BG divested itself of Lattice Group plc. (gas transportation) creating two separate companies. In October 2002, Lattice merged with National Grid to form National Grid Transco. Both demergers were driven by purely commercial considerations, see SERIS, 'Ownership unbundling and downstream investment by UK gas companies 1985–2005', Sheffield, March 2007. What has to be conceded though is the fact that only because of the regulatory enforcement of strict legal and internal unbundling did British Gas take the commercial decision, which was also in the interest of its shareholders, to divest itself of Centrica, its supply business. Regulatory intervention thus indirectly contributed to this commercial decision, which was taken after attempts in 1992 and 1993 to enforce ownership unbundling when first OFGEM proposed the divestment of British Gas' trading activities in terms of ownership unbundling and later the Competition Commission (then called Monopolies & Merger Commission). Both attempts were, however, rejected at the time by the Secretary of State. See in greater detail, Volz, n. 670.

four LDZs, i.e. the medium and low-pressure pipeline systems, are also owned and operated by NGG. The remaining four were sold by NGG in 2005.[1049] In the context of the gas market, there is no distinction made in law between transmission and distribution activities.[1050]

In addition to NGG, there are also so-called Independent Gas Transporters (IGTs), which develop and operate smaller gas transportation networks connecting to the main pipeline system. IGTs and NGG compete amongst them to provide gas transportation services in new areas such as housing developments.[1051]

The UK electricity supply industry, on the other hand, was privatized by the Electricity Act 1989 after taking into account the mistakes made in the privatization of the gas sector, mainly by privatizing British Gas vertically integrated without ensuring that sufficient competition existed right from the start of the privatized sector. The position in Scotland is different from that in England and Wales, and will be of particular interest in the subsequent legal analysis of further unbundling measures.

The state monopoly over electricity covered the complete electricity supply chain from generation, transmission and distribution to supply. The most important state company, the Central Electricity Generating Board (CEGB) was responsible for generation and transmission activities. Regional monopolies (twelve in England & Wales plus two in Scotland), the Area Boards, dealt with distribution[1052] and supply. The CEGB was in control of the system with the Area Boards subordinate.[1053]

The two Scottish Area Boards were initially privatized vertically integrated with generation and supply of electricity leaving electricity transmission and distribution in Scotland in the ownership of two companies, Scottish Power (SP) and Scottish and Southern Energy (SSE).[1054] Separation has taken place in the form of legal unbundling; the operation of the electricity transmission networks

1049 Bremen, n. 1028, no. 15.20. As a consequence, OFGEM had to change the regulatory structure because after the sale Transco was not the only provider of gas transportation via distribution networks.

1050 Gas transporter activities are licensed according to s. 7 of the Gas Act 1986.

1051 Bremen, n. 1028, no. 15.17.

1052 Electricity distribution networks in the UK range from 132kV to 230V. It is their role to provide a connection between the transmission grid and customers but there are also some generating plants connected directly to the distribution system (so-called embedded generation), see on this issue, Brunekreeft/Ehlers, nn. 8, 38.

1053 Volz, n. 670.

1054 As to the history, Volz, n. 670, and Dow, n. 333, no. 15.24.

were, however, taken over by National Grid Electricity Transmission plc. (NGET – formerly National Grid Company plc. or NGC), the England and Wales electricity transmission network owner and operator.[1055] Group integration in Scotland today thus covers electricity transmission network ownership, distribution ownership and operation and electricity generation and supply. Electricity supply in Scotland therefore consists of two vertically integrated companies, with the opportunity for other companies to establish generation and supply businesses.

In England and Wales, the break-up of the CEGB led to the transfer in 1990 of its electricity transmission network ownership and operation to a new company, NGC (now NGET), which was owned by the 12 Regional Electricity Companies (RECs) through a holding company, National Grid Group plc. (now National Grid plc.). In 1995, shares in this holding company were listed on the London Stock Exchange. Within a year, most of the RECs had disposed of their interests. National Power took over approximately 50% of generation[1056] in England and Wales and was soon taken over by German RWE. PowerGen took over 30% and was soon taken over by German E.ON. Electricity generation from nuclear was initially (not substantially but only formally) privatized as two new state-owned companies, Nuclear Electric and Scottish Nuclear, registered as private companies under the Companies Act (with all shares owned by the Secretary of State), which owned and operated the nuclear power plants.[1057] As the law did not require any parliamentary approval for a sale of the shares to the private sector (substantive privatization), Nuclear Electric and Scottish Nuclear could be sold by the Secretary of State on his own authority. British Energy plc., the successor to Nuclear Electric and Scottish Nuclear, was sold (substantively privatized) by the UK government in 1996.[1058] At the time of privatization, it had more than 20% market share, which has only slightly dropped since.

In 1990, the twelve English and Welsh and two Scottish Area Boards were replaced by Regional Electricity Companies (RECs), which were then privatized vertically integrated as 14 Public Electricity Suppliers (PES). The activities of distribution and supply were not separated but retained the monopoly distribution right over the authorized area plus, before full liberalization, the supply monopoly

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1055 Which was the result of the introduction of BETTA by the Energy Act 2004. For further details on BETTA, see *infra*.

1056 It was originally planned to be 70%, which would have included nuclear, which accounted for approx. 20% of generation, see Dow, n. 333, no. 15.12, and Volz, n. 670.

1057 Dow, n. 333, no. 15.213.

1058 The UK government, which initially retained 35.2% of the shares has in the meantime sold its share to French incumbent energy supply undertaking, state owned EDF, see http://news.bbc.co.uk/2/hi/business/7632853.stm.

to consumers within that area who were not "eligible" at the time (i.e. they were below a certain demand threshold above which they could have chosen their supplier). What was imposed, however, was accounts separation.[1059] The Distribution Network operators (DNOs) are the successors of the distribution arms of the PESs as a result of the Utilities Act 2000, which required separate licences for their supply and distribution businesses to be held by different legal entities, thus effecting legal unbundling. As the geographical areas of the former PESs remained unchanged, the former PES areas are used as the basis of the distribution areas which exist today. The post-privatization structure in the electricity sector was significantly altered at the end of 1995 when the PESs were required to dispose of their shareholdings (up to 14.9%) in NGC.[1060]

In addition to DNOs, there are also so-called Independent Distribution Network Operators (IDNO) since 2001. IDNOs own and operate electricity distribution networks which will predominately be network extensions connected to the existing distribution network, e.g. to serve new housing developments.

In April 2007, seven distribution companies operating twelve licensed distribution areas were active in England and Wales; some remained vertically integrated with electricity supply, some others are stand-alone.[1061] In Scotland, distribution is operated by the two above mentioned vertically integrated energy companies, Scottish Power (ultimately owned by Spanish Iberdrola) and Scottish and Southern. Each distribution company holds a separate licence for each area they cover.

Largely as a result of privatization, England and Wales is compliant with ownership unbundling of its electricity transmission. The continuation of ownership unbundling (in gas as well as electricity) is, however, not a result of formal legislation but exclusively enforced via licensing, which will be discussed further below in this section.[1062]

1059 In 2002 when as a result of market consolidation, nine distribution companies operated the twelve England and Wales areas, six of them were vertically integrated with electricity supply whereas the remaining three were ownership unbundled. See in greater detail, Volz, n. 670, p. 89.

1060 See Volz, n. 670, pp. 88–9. The fundamental rights relevance of this compulsory divesture will not be discussed here any further. At the end of 1995, National Grid sold its remaining generation activity as well, see in greater detail Volz, n. 670, p. 88.

1061 Volz, n. 670, p. 89.

1062 Electricity transmission in England & Wales and gas transmission in GB is not allowed to engage in electricity generation, or electricity and gas trading or supply except for balancing purposes, see National Grid's electricity transmission Standard Licence Condition C2 'Prohibited Activities' and TransCo's gas transporter Special Licence Condition 26 'Prohibited procurement activities'.

Although the approach to electricity privatization compared to gas privatization certainly resulted in the creation of competition in generation, the market was dominated by two major players.[1063] In addition, it also happened that some RECs/PESs were taken over by privatized water utilities in the same geographical area leading to the creation of multi-utilities.[1064] On the face of it, this type of horizontal integration should not cause competition authorities the same problems as vertical integration.[1065] However, private for-profit multi-utilities can draw financial support for (financially volatile) supply activities (including cross-subsidization) from (financially stable) revenues of other activities within the horizontally integrated utility, which might put them at an advantage over "purely" regulated vertically integrated mono-utilities.[1066]

2. REGULATION

The framework for regulating the energy industry in the UK consists of primary gas and electricity legislation, conditions of licences, which industry players are required to hold, and industry codes, compliance with which is required by relevant licence conditions.

The Electricity Act 1989 and the Gas Act 1986 provide the legal framework for the structure of the electricity and gas industries, respectively. The Utilities Act 2000, which amended the Gas and the Electricity Act, brought about extensive changes to the regulation of the gas and the electricity markets. Most importantly, the Utilities Act established the Gas and Electricity Markets Authority (GEMA) merging the regulators for the gas and electricity markets in GB. Most recently, further changes have been introduced by the Energy Act 2004 and the Gas (Third Party Access) Regulations 2004.[1067] The Gas Regulations implement the 2003 Gas Directive in relation to gas storage and LNG facilities by amending the Gas Act to extend the application of TPA.

1063 For a critical view as regards vertical foreclosure between energy wholesale and retail and the lack of liquidity in the visible wholesale markets in the UK, which are dominated by six integrated energy supply companies, see Thomas, n. 25.

1064 Similar to some formally privatized but municipality owned undertakings in the Netherlands (such as Delta) and municipality-owned *Stadtwerke* in Germany where such horizontally integrated multi-utilities are also called "Querverbund".

1065 Dow, n. 333, no. 15.237.

1066 Which are usually prevented from drawing on such financial support by regulation. On cross-subsidization in the electricity sector, see Willems/Ehlers, n. 2. This situation differs from the "Querverbund" in Germany, which is usually not private and not-for-profit and which cross-subsidizes other services of general (economic) interest, see chapter 4 on Germany.

1067 SI 2004 No. 2043.

The Secretary of State for Business, Enterprise and Regulatory Reform with its Energy Minister as junior Minister are responsible for energy policy at Cabinet level. Powers and duties under the Electricity Act 1989 and the Gas Act 1986 are shared between the Secretary of State and the regulatory authority OFGEM[1068], although in practice the Secretary of State delegates his authority to OFGEM's Director. The powers are given to the Director personally, a characteristic of all UK utility regulators. The Director is appointed by the Secretary of State but as separate statutory body (largely) independent of government and political influence, at least with respect to the competences conferred upon the Director exclusively. He is, however, accountable to Parliament and appointed for a five-year, once renewable term and cannot be removed except on grounds of incapacity or misbehaviour.

The regulator is an economic regulator (technical regulation remains the province of the Secretary), overseeing the development of competitive gas and electricity markets.[1069] The Minister's inherent powers mentioned above may provide a mechanism for future government involvement, particularly in licensing decisions, which would, if exercised, result in a significant impairment of the regulator's independence. The Utilities Act also confers an additional power to the Secretary of State to give general directions to the regulator, which does not seem to be too conducive to the regulator's independence. In specific cases, however, the Secretary is still not allowed to intervene.

OFGEM has powers to grant licences and modify the conditions of licences and powers and duties to monitor the activities of gas and electricity companies, and to take enforcement action necessary to ensure compliance with their statutory and licence obligations. It has the power to impose financial penalties on licence holders for breaches of those obligations up to a maximum of 10% of their annual turnover.

A principal tool for OFGEM to achieve its regulatory objectives is the ability to modify licence conditions. OFGEM's powers to modify licence conditions allow it to adapt the regulatory framework to achieve desired market changes and to address developments in the market including the conduct of mergers. In the

1068 Office for Gas and Electricity Market, through which GEMA operates and which is represented by the Director General of Gas and Electricity Markets, who is the successor to the Director General of Electricity Supply and the Director General of Gas Supply; both offices (Office for Electricity Regulation OFFER and Office for Gas Supply OFGAS) have been merged by the Utilities Act 2000 to create the Office of Gas and Electricity Markets (OFGEM), see also Bremen, n. 1028, no. 15.03.

1069 With an emphasis on price control of the non-competitive element of the electricity and gas supply chains, i.e. transmission and distribution.

absence of the consent of the licensee(s) to a modification of a licence condition, OFGEM may only impose the modification if the Competition Commission (CC) has endorsed the proposed modification.

A further tool for OFGEM is the power to modify the various industry codes. This power is conferred by the relevant licence condition under which a network operator is required to maintain the code in question, and currently is not subject to any specific statutory constraints. The Energy Act 2004 introduced provisions allowing OFGEM's decisions about electricity and gas code modifications to be appealed against to the CC in some circumstances.[1070]

OFGEM's actions are inter alia subject to accountability through general administrative law.[1071] Under English administrative law, judicial control over the decisions of public bodies is exercised through judicial review, at which judges can quash decisions, require them to be taken again (according to the judges' requirements), prohibit bodies from acting outside their powers, and issue declarations as to the correct interpretation of those powers and the relevant law. The HRA brought the ECHR into English law which adds a further dimension to the administrative law framework within which regulators such as OFGEM operate.[1072]

Parliament plays an important role in holding regulators to account for their performance of their duties at a strategic level. Most parliamentary scrutiny takes place in Select Committees, such as the Trade and Industry Select Committee and the Environmental Audit Committee, which may call the regulators before them.

The energy industries also remain subject to competition law. Accordingly, both the Office of Fair Trading (OFT) and the Competition Commission (CC) are also involved in energy industry matters. The OFT is responsible for the protection of

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1070 The Energy Act 2004, however, also confers upon the Secretary of State the power to make an order specifying which codes this appeal process will apply to and any types of decisions, which may be excluded from the right of appeal.

1071 Its decisions are administrative in nature, rather than judicial and can thus be subject to judicial review, in the same way as other administrative decisions in the UK. The body of law dealing with judicial review in the gas and electricity context is no different to other judicial review procedures.

1072 Judicial review is concerned with the legality of decisions and thus only to a very limited extent includes features of an appeal mechanism on the merits of a decision, namely when it comes to the application of the proportionality test. The introduction of the proportionality test by way of common law into English administrative law as a consequence of the HRA and thus the ECHR means a substantial adjustment to the distinction between appeal and judicial review because it balances the merits of a case against their proportionality. See Tomkins, n. 543, p. 199, and n. 1148.

general consumer interests, which links into the behaviour of participants in competitive markets, while the CC is specifically concerned with mergers, maintaining competition in markets, and the regulation of the regulated industries such as energy. Generally, the OFT is involved in complaints about specific company behaviour affecting consumers while the CC is concerned with anti-competitive behaviour affecting an industry sector. Both have in common that they investigate competitive abuses; in particular the CC must report on whether the activity under scrutiny operates against the public interest. However, it should be noted that the CC reports to the Secretary of State who is under no obligation to accept its recommendations; indeed, he can ignore them.[1073] The CC can deal with general investigations as well as with specific investigation of takeovers and mergers.[1074]

The regulatory regime applying to the gas and electricity markets is a 'standalone' regime in that it does not rely on general competition law to create a competitive and liberalized market that complies with the 2003 Energy Directives. However, general competition law does apply to the gas and electricity markets. In particular the provisions of the Competition Act 1998 and the Enterprise Act 2002 dealing with anti-competitive practices play a particularly important role. Importantly, OFGEM has concurrent powers[1075] with the Director General of Fair Trading (DGFT) to apply the Competition Act and Enterprise Act prohibitions in the gas and electricity sector.[1076] These concurrent powers also

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1073 Which has happened in the case of CC's proposal in the mid 1990s to break up British Gas, see in greater detail, Volz, n. 670.

1074 See in greater detail, Bremen, n. 1028, no. 15.106, and Dow. n. 333, no. 15.31. The Competition Appeal Tribunal (CAT) inter alia hears appeals on the merits (review of law and facts) in respect of decisions made under the Competition Act 1998 (as amended) by the OFT and the sector-specific regulators such as OFGEM, and reviews decisions made by the Secretary of State, OFT and the CC in respect of merger and market references or possible references under the Enterprise Act 2002.

1075 The Competition Act 1998 (Concurrency) Regulations 2004 (SI 2004 No. 1077) govern the interface between OFGEM and the DGFT. In particular, the Regulations deal with the exchange of information between DGFT and OFGEM for the purposes of determining who has jurisdiction to exercise concurrent functions in relation to a case; determine who should exercise prescribed functions in relation to a case and resolve any disputes which may arise in relation to this issue; the prevention of simultaneous exercise of functions by both bodies in relation to a case; the transfer of cases from one body to another; and the provision for the DFGT and OFGEM to use each other's staff. The Regulations are supplemented by a Concordat between the DGFT and OFGEM as to the exercise of their concurrent powers in relation to gas and electricity markets.

1076 The relevant provisions of the Competition Act are prohibitions on agreements that prevent, restrict or distort competition (so-called Chapter I prohibitions) and on conduct by undertakings which amounts to an abuse of a dominant position (so-called Chapter II prohibitions). Under the Enterprise Act, the DGFT (or OFGEM in the case of the gas and electricity sector) may make a reference to the Competition Commission if there are reasonable grounds for believing that any feature, or combination of features, of a market in the UK for

apply with respect to the application and enforcement of Articles 81 and 82 EC.[1077]

The merger control provisions under the Enterprise Act also apply to the gas and electricity sector. Under the Enterprise Act, the Director General of Fair Trading must refer an acquisition for a detailed investigation by the Competition Commission if it believes the transaction may be expected to result in a substantial lessening of competition within any market in the UK. In accordance with the Concordat between OFGEM and the Office of Fair Trading[1078], the DGFT consults OFGEM in relation to mergers relating to the gas and electricity markets.[1079]

These concurrent powers apply only to activities for which a licence is required under the Gas Act and the Electricity Act, and activities ancillary to those activities. All other sectors of the economy (such as upstream and offshore activities not ancillary to those activities) are overseen exclusively by the DGFT.

Network regulation

The duties of the regulator are aimed at ensuring that his functions are carried out 'in a manner which he considers is best calculated' to achieve the relevant objective.[1080] In addition to his duties in the context of network regulation, further duties relate to ensuring the financial capability of licensed electricity and gas suppliers, the protection of the consumer interest in respect of prices charged and other terms of supply, the promotion of efficiency and economy on the part of suppliers, the protection of the public from the dangers associated with electricity and gas supply and the special consideration of the interests of the disabled and those of pensionable age.

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goods or services prevents, restricts or distorts competition in connection with the supply of acquisition of any goods or services in the UK.

1077 OFGEM's powers under the Competition Act include the power to consider complaints about breach of the prohibitions, to impose interim measures to prevent serious and irreparable damage, to carry out investigations both on its own initiative and in response to complaints, to impose financial penalties taking account of the statutory guidance on penalties issue by the DGFT, to give and enforce directions to bring an infringement to an end, and to issue general advice and information on how the Competition Act applies to the gas and electricity sector. See OFGEM, 'Competition Act – Application in the Energy Sector', August 2004.

1078 See n. 1075.

1079 As regards judicial review of decisions made in this context, see n. 1074.

1080 S. 4 of the Gas Act 1986 sets out the duties of the Director, which have been amended by the Gas Act 1995, the Competition and Services (Utilities) Act 1992, and the Utilities Act 2000. Similar, see s. 3A of the Electricity Act 1989.

One of the main tasks of the regulator is to set the gas transportation and electricity transmission and distribution tariffs[1081], i.e. to regulate the monopoly aspects of the gas and electricity markets through a price control regime. There are separate price controls for electricity network ownership and system operation.[1082]

A price control typically lasts for five years at the end of which a new control is set, after detailed consultations within the industry, by means of modifying the relevant licence condition. The setting of a price control requires OFGEM to decide the value of the existing regulatory asset base and future capital expenditure to develop the network during the next control period, an allowed cost of capital, which (together with depreciation) dictates the revenue required to cover such past and future investments, and the fixed and variable operating expenditure during the price control.

Licensing

The primary means of regulating electricity and gas supply is by requiring participants to hold licences. The licence is also a convenient method of identifying those involved in the industry[1083], that is, establishing who is the subject of regulation as well as being the instrument of control over that participant and in addition it enforces general competition law by, for example, making the energy

1081 Until the market was completely liberalized but even for some time after full competition was introduced (i.e. until 2003), the regulator was also involved in setting the consumer price for gas. Tariffs are set according to the RPI-X formula. The formula restricts price increases to a level (the X factor) below the retail price index (a measure of inflation). Accordingly, the regulator sets the increase in the price the utility may charge the consumer. The effect is to provide an efficiency incentive for the utility. For example, if X were to be set equal to the rate of inflation, there would be no real revenue increase for the utility. It must therefore cut costs to remain as profitable as before, bearing in mind that inflation will affect its costs while the price control prevents a corresponding rise in revenues. The incentive is increased by allowing the utility to keep any additional efficiency savings it might make. For example, if the formula requires a 2% gain to maintain profitability, but the utility manages a 5% efficiency gain, the extra 3% is profit for the utility. Dow, n. 333, no. 15.156.

1082 Non-monopoly activities of electricity generation and gas and electricity supply are not subject to price controls. It should be noted, however, that this freedom to set prices is subject to a variety of consumer protection obligations imposed on the licensees by their licence conditions.

1083 The UK continues not to have any specific list of public service obligations. There is, however, a set of standard conditions attached to all licences, which are approved by the regulator in order to protect the public interest in the way in which the licensee carries out its activity. Public service obligations are reflected in these conditions, such as obligations to offer connection, and occasional restrictions on disconnection. Further, the Grid Code for electricity and the Network Code for gas, see nn. 1096, 1100 and accompanying text, also contain detailed provisions on access rights.

transport licences of NGET and NGG independent of other energy chain activities elsewhere in the group.

In the gas sector, OFGEM has the power to issue three distinct types of licence: first, those involved in arranging transport of gas with the pipeline company, so-called shippers, require a licence. This is aimed at intermediary gas marketers, which appeared on the scene as a consequence of the liberalization of the gas market after which persons who to date had not usually been involved in the gas market could in principle become involved, such as banks or supermarkets. The shipper would arrange for the gas to be supplied, dealing with the pipeline company, and the bank, supermarket or the like would deal with "its" customers and the payment.

Another type of licence is required for so-called public gas transporters, which consist of NGG, a subsidiary of National Grid plc.[1084], as national gas transporter and some other (much smaller) companies, four of which hold public gas transportation licences for regional gas distribution networks[1085] and some others for small areas covering new developments "carved out" of NGG's licence.[1086] Under section 7A of the Gas Act 1986 as amended by the Utilities Act 2000 and Energy Act 2004, the holder of a gas transporter licence is precluded from holding a gas supply or gas shipper licence.[1087] In theory this means legal unbundling, as in the case electricity, because different legal persons within a group of undertakings can hold different gas and electricity supply related licences. However, NGG's gas transporter licence enforces ownership unbundling by way of licence condition.[1088]

The third type of licence concerns the competitive activity of gas supply, which is the contracting with a customer to sell the product. The most significant (legal) hurdle for a prospective supplier is the requirement to satisfy the regulator that the applicant is an appropriate person to hold the licence, which does not cause too great a problem as long as the ability to perform this activity can be

1084 For the history, see Volz, n. 670.

1085 In 2004, NGG sold four of its regional gas distribution networks but retained ownership of four others, which comprise almost half of GB's gas distribution network.

1086 Storage services are offered by independent storage operators. Neither the operation nor the ownership of gas storage facilities is a licensed activity under the Gas Act. However, the Gas Act 1986 (and the Petroleum Act 1998) impose obligations on onshore and offshore gas storage facility owners, which facilitate third party access.

1087 Bremen, n. 1028, no. 15.15. The Energy Act 2004 amended the Gas Act 1986 to provide that the holder of a gas interconnector licence is also precluded from holding a gas supply or gas shipper licence.

1088 See Special Licence Condition 26, n. 1062 and accompanying text.

demonstrated and there is no history of financial irregularities or other inappropriate activities.

As in the case of gas, in the electricity sector each activity has its own licence. A further form of licence is the electricity transmission licence and the electricity distribution licence. The former is held by NGET, a subsidiary of National Grid plc. (as is NGG, its gas equivalent), and by the two Scottish electricity transmission network owners.[1089] The latter is held by the DNOs, which own and operate local electricity distribution networks within their geographical areas.

In addition to the (onshore) transmission licence, the Energy Act 2004 introduced a licensing regime for electricity interconnectors allowing connection to and from other countries onto or from the UK transmission grid.[1090]

Similarly to gas, section 6 of the Electricity Act 1989 as amended by the Utilities Act 2000 prescribes that one (legal) person cannot hold an electricity distribution licence and an electricity supply licence. This implements legal unbundling in the

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1089 There are two types of electricity transmission licences. NGET's licence reflects its function as national electricity transmission system operator (in addition to its ownership function in England and Wales), for which assets required to operate the system in Scotland have "voluntarily" been transferred to NGET by the two Scottish electricity transmission network owners – "voluntarily" because otherwise they would have been expropriated. See in this regard, the 'Explanatory Notes to Energy Act 2004 Chapter 20', nos 351, 352 (available at www.opsi.gov.uk/acts/acts2004/en/04en20-g.htm). According to nos 351 and 352, section 141 of the Energy Act 2004 (which laid the foundation for the introduction of BETTA) gives Schedule 18 effect, which provides for a scheme for the transfer of property (i.e. expropriation). OFGEM in its Memorandum (Appendix 11 to the Minutes of Evidence of the House of Commons Trade and Industry Committee's 5th Report of 1 April 2003 (Session 2002–03) on 'The British Electricity Trading and Transmission Arrangements') in note 18 comments on the enabling powers to make a property arrangements scheme as follows: "[…] There may be a need to transfer some assets to the new system operator to enable it to undertake this function across GB. It is expected that such transfers will be agreed voluntarily between the companies concerned, but if they cannot agree, the [property arrangement] scheme [contained] in the [draft] Bill is present as a backstop to ensure that timely implementation cannot be frustrated. […] The companies may apply to the [Gas and Electricity Markets] Authority [GEMA] for a determination, and that determination can be subject to appeal to the Competition Appeals Tribunal (CAT)." The other licence reflects the "mere" transmission ownership function of the two Scottish companies. See also n. 1062 as regards the licence conditions enforcing ownership unbundling of energy networks. The relationship of these two transmission functions is subject to the so-called System Operator/Transmission Owner (SO/TO) Code (available at www.nationalgrid.com).

1090 The UK is connected to France with a rather significant interconnector capacity. Additionally, there is a smaller interconnector to Ireland (and until BETTA became operational, Scotland and England and Wales were connected through an interconnector, which has now become part of the Great Britain transmission grid operated by NGET). The most recent interconnector project is the Isle of Grain interconnector to the Maasvlakte in the Netherlands, which received consent in July 2007 according to s. 6A(5) Electricity Act 1989.

law.[1091] Within a group of undertakings, two separate legal persons within a group are, however, not precluded from holding the other of the two licences or, more generally, different gas and electricity supply related licences.

As regards National Grid plc., which owns inter alia the England and Wales electricity transmission network owner and GB electricity transmission network operator NGET and the GB gas transmission owner and operator NGG, the holding of a licence other than an electricity transmission (and distribution) or gas transporter licence is prohibited group-wide (i.e. for any affiliate or related undertaking).[1092] This amounts to a requirement to refrain from vertical integration, which is not required in other cases.[1093] As a result, the entire group of National Grid plc. is prevented from pursuing any activity in the gas and electricity supply chain other than electricity transmission (and distribution) and gas transporter and related activities such as system balancing (in both cases), i.e. in particular the purchase or acquisition in any other way of electricity or gas for the purpose of sale.

This cements the energy sector structure as established by the electricity sector privatization and the voluntary breaking-up of BG, thus amounting to the enforcement of ownership unbundling, or better, the prevention of vertical integration of the national transmission and transportation networks with electricity generation and energy supply. What this also means on the other hand, however, is that energy suppliers can (still) vertically integrate with electricity generation thus reinforcing the concentration in the energy markets.[1094]

1091 Similarly, the holder of an electricity interconnector licence will be precluded from holding a licence with respect to any of the four other electricity activities licensed under the Electricity Act 1989, which is targeted against the possibility of anti-competitive practices such as capacity hoarding in the operation of interconnectors. In addition to legal unbundling, there are also various provisions in the relevant licences dealing with accounting and management separation relating to the various businesses that may be undertaken by the licence holder. The purpose of all these provisions is to ring-fence the regulated, licensed activities from each other and (possibly) from other activities (not related to energy supply) that may be undertaken by the licensee. In the case of network businesses, there are also licence requirements to ensure management and financial independence of other business or group companies. The unbundling and separation provisions are supplemented by various licence conditions prohibiting discrimination and cross-subsidies.

1092 See nn. 1062, 1089.

1093 Apart, obviously, from the fact that, since the introduction of BETTA with NGC appointed as GB electricity transmission system operator, the two vertically integrated Scottish energy supply undertakings are not, as electricity transmission owners, allowed to pursue electricity transmission system operations elsewhere within their respective group of undertakings.

1094 Such an issue arose first when the PES Manweb was taken over by Scottish Power. As Scottish Power already owned generating plant, there was a risk that self-generated electricity would be sold to a vertically integrated supply business for a favourable price and not at market price. The takeover was nevertheless allowed but controlled by way of imposing additional licence

The justification for licensing is partly strategic and partly administrative. Given the strategic importance of energy supply, licensing is a manner of retaining state control in order to safeguard reliability and security of energy supply. Licensing is intended to control the activities of the participants in the electricity supply industry, i.e. their (choice of) economic activity. Licensing provides a means to ensure that all participants are subject to the same rules because the licence conditions display the minimum requirements for the participation in the industry. Licence conditions are also aimed at ensuring that service standards are maintained in the competitive environment, and at reducing the risk that insufficient expert (or under-capitalized) companies enter the market, which would pose a threat to supply security.

However, licensing also serves as a tool to enforce competition policy. As there is no absolute bar in the law to holding more than one type of licence within a (legally unbundled) group of undertakings and thus no sector-wide regulation in this respect, it is the licensing regime which offers the means to effect such a bar in individual cases as can be seen in the case of NGET and NGG where such licence conditions exist. The post-privatization structure in the electricity sector and post-divestiture structure in the gas market is thus controlled and maintained by means of general competition law[1095]; licensing can thus be said to be a means

conditions. An economic purchasing or "arm's length" clause was introduced limiting the amount of power a supplier could buy from a related generator. Any power above 15% of Manweb's total needs had to be purchased on terms demonstrated to be the most economically advantageous available in the market. Otherwise, OFGEM would be able to unwind the transaction. See in greater detail, Dow, n. 333, no. 15.237. The shift of the burden of proof sounds familiar in the context of the German law environment. In Germany, the competition authority BKartA (not the regulatory authority BNetzA) has the power according to s. 29a GWB to invalidate energy price rises (exclusive of network charges, which are exclusively regulated and supervised by the regulator) if the energy undertaking is not able to show that such price rises are justified as market adequate. See in greater detail, chapter on Germany. For a harmful example of vertical integration leading to anti-competitive concentration, see New Zealand. For more detail on New Zealand, see *infra*.

1095 It appears that the imposition of these prohibitive licence conditions on NGET and NGG, which are not directly derived from legislative provisions, flow from OFGEM's general competition enforcement powers conferred upon it by both the Gas and Electricity Acts. In the case of offshore electricity transmission, ownership unbundling does not seem to be enforced (via licence conditions). See in greater detail OFGEM's recent consultation on the implementation of a regulatory regime for offshore electricity transmission, 'Offshore Electricity Transmission – A further Joint OFGEM/DECC Regulatory Policy Update', Consultation, Ref: OFGEM (153/08), DECC (URN 08/1185), 20 November 2008. Offshore electricity transmission means the cables bringing offshore electricity generation on land and feeding it into the onshore electricity transmission network. The operation of offshore electricity generation (OFTO) and the consultation in this respect is a good example of the anticipated application of the draft Electricity Directive, n. 33, where a Member State has not yet decided to implement a specific option or where it wants to leave such decision open. Accordng to the plans of OFGEM published in the before said consultation, an electricity generation undertaking cannot own an OFTO; a legally independent OFTO, however, could

to maintain the ownership unbundled structure of gas and electricity transmission.

Access rules

Under the Gas Act gas transporters have a duty, so far as it is economical to do so, to comply with any reasonable requests to connect to their pipeline system, and to facilitate competition in the supply of gas.

The terms of access to the whole pipeline system owned and operated by NGG are set out in the Network Code[1096], which NGG is required to maintain under the terms of its gas transporter licence. The Network Code is given effect to by a Framework Agreement, in the form of a contract between NGG and individual gas shippers. In addition to NGG's Network Code, each Independent Gas Transporter (IGT) has its own network code to maintain.

Access to the gas network is provided on an entry-exit basis rather than a point-to-point basis. Access rights comprise entry and exit capacity at entry and exit points. The cost of access to the network is based on entry charges and exit charges (both capacity and commodity charges) and there is a single notional balancing point for the network.[1097]

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be integrated in a vertically integrated energy supply undertaking if the OFTO also owns the cables (thus a property transfer scheme of already existing cables is supposed to be put in place). Such legal unbundling would be in accordance with the draft Directives (and their minimum requirements, i.e. the ITO model).

1096 The Network Code sets out the rules for the use of the transportation network. It is basically a contract with regulatory elements. Since signing the Code is a licence condition all users of the gas pipelines and the network operator are bound by its terms, which are approved by the regulator. One of the most important provisions of the Network Code is the implementation of daily balancing, the financial responsibility for which lies no longer with the pipeline company but with the suppliers. Satisfying this requirement involves metering, another major issue of the Network Code, which is also important i with respect to the payment of suppliers by customers. Upon privatization and liberalization metering was taken over by the suppliers. NGG is merely acting as balancing agent of last resort. The Network Code provides for a degree of flexibility: a supplier who is short of gas can buy gas from a supplier who has gas in excess, which might be cheaper than paying a penalty to NGG for being out of balance, or he can purchase gas on the spot market, trading on which is not for instant delivery, i.e. not on the balancing day, which enables direct trading between suppliers. Alternatively, the supplier can withdraw gas from storage. The arrangements for storage and access to it are also prescribed by the Network Code. See also Dow, n. 333, no. 15.178.

1097 Similarly, at one notional point in the onshore UK gas pipeline network, the International Petroleum Exchange in London offers spot contracts for trading gas within the UK pipelines. Additionally, producers can simply put gas into the network; the Network Code (n. 1096) shifts the obligation to deliver the right amount of gas at the consumption point onto the public gas transporter so that the seller fulfils his delivery obligation when putting the gas on the network. See Dow, n. 333, no. 15.188.

As part of New Gas Trading Arrangements introduced in October 1999 an auction mechanism was implemented for the allocation of entry capacity by NGG. The right sold in the auctions is the right to enter up to a maximum daily volume of gas at a given point for a given period of time. Access to the National Transmission System (NTS) is available on a short-term[1098] and a long-term basis. 80% of the system entry is offered in long-term entry capacity auctions; the remaining 20% is reserved for release in shorter-term auctions allowing new entrants and existing players to secure entry capacity in the short-term. In addition to bidding to purchase entry capacity from NGG, gas shippers can also trade entry capacity with other gas shippers. This secondary market is an important component of the way capacity rights to the NTS are allocated.

Similarly to gas, under the electricity transmission licence, NGET is required to maintain various industry codes dealing with the operation and use of the transmission system, including the Connection and Use of System Code (CUSC)[1099] and the Grid Code (GC).[1100] The CUSC is given contractual effect by the CUSC Framework Agreement, which is signed up to by all persons wishing to connect to or use the transmission system.

Under the Electricity Act 1989, DNOs have the obligation to make a connection between their distribution system and any premises when requested to do so by the owner of the premises or an authorized electricity supplier. Similarly to the obligations of NGET under its transmission licence, under the terms of their distribution licence DNOs are each required to maintain and comply with a Distribution Code dealing with the technical aspects relating to connections to and the operation of the licensee's distribution system, and which must facilitate competition in the generation and supply of electricity.

1098 In daily and monthly blocks with six months of capacity offered twice a year. Interruptible entry capacity for individual days is also released in daily auctions. NGG also releases a daily interruptible entry capacity product, based on the extent to which holdings of firm capacity rights exceed the quantity of deliveries of gas at each NTS entry point. This is referred to as 'use-it-or-lose-it' capacity and is intended to operate as an anti-hoarding device.

1099 The CUSC constitutes the contractual framework for connection to, and use of, NGET's transmission system, and contains commercial provisions governing that connection and use. It inter alia sets out the right of system users to obtain and maintain connection to the transmission system.

1100 The GC deals in detail with all material technical aspects relating to connections to and the operation and use of the transmission system. All users of the transmission system are required to comply with the GC.

Infrastructure investment

The Electricity Act expressly imposes a duty on transmission and distribution licensees to develop and maintain efficient, coordinated and economical systems of electricity distribution and transmission and to facilitate competition in the supply and generation of electricity. An equivalent obligation applies to gas transporters under the Gas Act.[1101] There are, however, no specific powers for OFGEM or the Government to direct electricity transmission and distribution licensees or gas transporters to expand their networks. OFGEM thus provides financial incentives for NGC and NGG as part of its tariff regulation to invest into new capacity.

Liquefied natural gas

Liquefied natural gas (LNG) is becoming an ever increasing part of the UK gas market. To encourage the building of expensive LNG *infra*structure, the UK has granted exemptions from TPA under section 19C of the Gas Act 1986 as amended. In the case of the regassification plant at the Isle of Grain, the first phase became operational in 2005. After initial concerns on the part of OFGEM, the arrangement was adjusted by obliging the terminal operator to put effective anti-hoarding measures in place.[1102] The exemption relating to TPA was granted for the expansion of the facility rather than for the initial construction, and applies to auctioned capacity (open season) only.[1103]

British Electricity Trading and Transmission Arrangements (BETTA)

In April 2005, the British Trading and Transmission Arrangements became operational in GB extending the New Electricity Trading Arrangements (NETA) for England and Wales[1104] by providing a set of trading, balancing and settlement

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1101 See Bremen, n. 1028, nos 15.09, 15.13, 15.18.

1102 Thus executing the so-called 'use-it-or-lose-it' allocation of *infra*structure capacity in order to prevent primary capacity-holders from electing not to use the facility but nevertheless withholding the unused capacity from the market.

1103 Approval of the Commission according to Article 18 Gas Directive 2003 was granted late 2007, see also Part 1 Chapter 3 *supra*.

1104 NETA is the successor of the (compulsory) Pooling and Settlement Agreement between all electricity generators and all electricity suppliers, which was established upon privatization. The two main generating companies National Power and PowerGen were compelled to sell plant and reduce market share resulting in an increase in the number of generators, which together with the reduction in the ability of the dominant generating companies to predict the identity of the marginal generator, largely removed the abuse which had taken place under the Pooling Agreement, and thus the competition problem in the UK electricity wholesale market. See in greater detail, See Dow, n. 333, nos 15.239 *et seq.*, 15.244 *et seq.* The key feature of the bilateral systems NETA and BETTA is the so-called Balancing and Settlement Code (BSC)

arrangements common to all players in the electricity supply industry[1105], even where electricity supply undertakings with a vertically integrated structure are part of the market.

BETTA introduced a common electricity transmission system operator, which is separate from generation and supply interests, marking a radical change in Scottish arrangements, whereby electricity transmission was split into transmission ownership and transmission operation. The first function remained within the two vertically integrated Scottish electricity supply undertakings (which remain legally but not ownership unbundled), of which Spanish electricity group Iberdrola owns Scottish Power, and the second function was transferred to NGET, which now owns and operates electricity transmission in England and Wales (and the gas transmission and parts of gas distribution in Great Britain) and operates electricity transmission in Scotland.[1106] Consequently, NGET operates as a regional system operator[1107], operating the electricity (and gas) transmission systems of England, Wales and Scotland.[1108]

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approved by the regulator, which sets out the trading rules between the licensed generators and suppliers. Accordingly, all parties are able to enter bilateral contracts. The balancing requirements are met through self-dispatch by the generators. Generators are responsible under the Code for ensuring that their output matches their net contracted positions. Suppliers are responsible for ensuring that their net contracted positions meet the total demand of their customers. If there is an imbalance, system security is maintained by the network operator. There are three separate bilateral contract markets where the price of electricity is freely negotiated, i.e. long-term, medium-term and short-term contracts. The latter potentially pose a threat to supply reliability because short-term markets mean less security for generators in particular in terms of financing. Although such short-term contracts benefit (the financing of) merchant plant which sell into the market with no long-term off-take contract in place, traditional electricity generation plant financing has been on the basis of off-take contracts of fifteen years or more, creating reliability of supply and security of demand. That will almost certainly disappear as bilateral trading reduces the incentive for buyers to sign up to long-term deals. That has contributed to a lack of new electricity generation capacity in the UK in recent years, which so far has not really mattered as there is excess capacity. The fact is, however, that substitute capacity cannot be made bankable as there is no guarantee of selling output, which potentially affects long-term supply reliability. The result has been no new building of big electricity generation plants. See in greater detail, Dow, n. 333, nos 15.249 *et seq.*

1105 See, however, Thomas, n. 25, who is rather sceptical as regards the proper functioning of this new wholesale arrangement against the background of an increasing vertical concentration of generation and supply in the UK market. See further *infra* in the context of analysing the fair balancing of further unbundling measures in GB.

1106 NGET (formerly NGC) was appointed GB system operator on 1 September 2004.

1107 See B Moselle (The Brattle Group), 'The ISO model for Scotland: Lessons from UK experience', presentation at UNECOM workshop in Brussels, 27 April 2007.

1108 OFGEM as regulator has the last word in disputes about investment decisions with respect to the Scottish transmission networks, see in greater detail *supra* at the end of chapter 4 on Germany; it is nonetheless the TOs that are ultimately responsible for investment decisions planning based on input from and co-operation with the ISO.

In addition, the pricing arrangements for transmission and the access regime apply across all jurisdictions. The previous problems with access to the interconnector between Scotland and England, which were (partly) due to capacity constraints, have vanished in that the interconnector now forms part of one British electricity transmission system and BETTA effectively compels capacity auctions and creates a secondary market for capacity bought in advance but not going to be used (according to the "use-it-or-lose-it" principle).

BETTA brought about some changes to the licence arrangements in Scotland in that it adjusts the licences of Scottish Power plc. and Scottish and Southern plc. by making them subject to the same regulatory requirements as in England and Wales. It should be noted in this context that the improvements to the transparency of legal unbundling, which the introduction of BETTA injected into the regulation of the separately licensed activities including the separate transmission activities of NGET and the Scottish energy companies were considered sufficient to safeguard the competitive working of the electricity market in GB.[1109]

Regional cooperation

Within the seven electricity regional markets established in the context of the Regional Initiatives, also called Mini Fora, GB makes one such market together with France and Ireland (Republic of Ireland and Northern Ireland).[1110] For gas there are three such regional markets; the UK is part of the North-West market, along with Belgium, France, Denmark, Germany, the Netherlands, the Republic of Ireland, Sweden and Poland.[1111]

III. CONSTITUTIONAL SETTING

The United Kingdom of Great Britain and Northern Ireland is a Unitary State with a central government consisting of three separate legal systems with the largest jurisdiction being England and Wales. The government of Scotland is

1109 Dow, n. 333, no. 15.276; Bremen, n. 1028, no. 15.11; similar Moselle, n. 1107.

1110 N. 479 and accompanying text.

1111 N. 479 and accompanying text. Whereas generally, the Gas Regional Initiatives focus on issues such as interconnectors, market transparency and gas trading hubs, in the specific case of the North-West gas market, capacity auctions at specific interconnector points are the priority because there, the use of the existing network and total pipeline capacity are considered problematic. Auctions are designed to address the first issue and give signals about investment to solve the second issue. See European Commission, 'Progress in creating the internal gas and electricity market', Report, COM(2008) 192 final, Brussels, 15.4.2008.

devolved and limited powers have been given to the Welsh assembly. Devolution has created greater political independence but energy policy remains a matter for the UK government in Westminster. Planning matters have however been devolved so that the Scottish executive does become involved in individual energy related projects.[1112]

The devolved regional governments and local government are both creatures entirely of statute.[1113] Unlike central government, local authorities have no reservoir of prerogative power.[1114] The competences and tasks of local authorities have no independent constitutional basis but are exclusively conferred upon them by Acts of Parliament. And Parliament has never, unlike the Netherlands with its *Provinciewet* and its *Gemeentewet*[1115], in general terms conferred upon local authorities the competence to set up and manage their own budget, which only happens on a case by case basis to fulfil specific tasks.[1116]

1. SOVEREIGNTY OF PARLIAMENT IN A UNITARY STATE

The doctrine of legislative supremacy or sovereignty of Parliament provides that as a matter of English law, there is no source of law higher than a statute, which means that Parliament[1117] may pass or cancel any law whatsoever, and that no court or other authority may override or set aside any Act of Parliament as a matter of English law. The doctrine of the sovereignty of Parliament is a doctrine of the common law.[1118] This means that as any other rule of the common or judge-made law, it may be developed, refined, re-interpreted, or even changed by the judges. Thus the doctrine of legislative supremacy on the one hand is fundamental

1112 Dow, n. 333, no. 15.01.

1113 Greater London has consisted of 32 boroughs since 1963 (with the medieval Corporation of London as the old centre of London still in place) headed by the Greater London Council. Counties and districts are two-tier systems of local government in England and Wales according to the Local Government Act 1972, some of which have been replaced by unitary authorities in England in 1985, 1996, 1997 and 1998 and in Wales in 1996. Scotland, on the other hand, has been divided into 29 unitary councils since 1996. All local divisions in Great Britain are headed by councils. See in greater detail, Prakke, 'Het Verenigd Koninkrijk van Groot-Brittannië en Noord-Ierland', in L Prakke and C Kortmann (eds), *Het staatsrecht can de landen van de Europese Unie*, 5th ed., 1998, pp. 853–4.

1114 The Royal Prerogative is a body of customary authority, privilege, and immunity, recognised in common law as belonging to the Queen alone. Today, most prerogative powers are directly exercised by government ministers with the approval of Parliament.

1115 See chapter 6 on the Netherlands.

1116 Prakke, n. 1113, p. 855.

1117 More accurately, Queen-in-Parliament, see Tomkins, n. 543, p. 93.

1118 Tomkins, n. 543, p. 103.

to the Constitution of the United Kingdom[1119], on the other it is no more entrenched or unchangeable that any other rule of English law.[1120]

a. Relationship between EC and national law

The doctrine of legislative supremacy, more particularly the principle that as a matter of English law, Parliament may bind its successors neither as to the substance nor as to the manner and form of subsequent legislation and that no court may set aside any Act of Parliament[1121], seems to have been put into question by the UK's accession to the European Economic Community, today's European Community, in 1972. This is because as a matter of EC law, Community law prevails over national law, even over national constitutional law.[1122]

1119 Horspool in Tettinger/Stern, A V ('Die Anwendung des Human Rights Act 1998 im Vereinigten Königreich'), no. 2, p. 55.

1120 The doctrine has indeed changed over time: it was only after Parliament had won the seventeenth century conflict with the Crown, i.e. after the English Civil War, that the courts formally recognized Acts of Parliament ranking higher in legal status than judge-made law, i.e. common law. Thus, Acts of Parliament enjoy supremacy in the hierarchy of legal norms, i.e. even over decisions of (Her Majesty's) judiciary. However, although the doctrine of legislative supremacy is a strictly legal doctrine, it nevertheless shows the English courts' deference to political reality, which means that should this reality change once again, there is nothing to stop the common law or judge-made law from changing with it, Tomkins, n. 543, p. 104. It is thus submitted that this judicial deference or openness to change together with the constitutional flexibility offered by an unwritten constitution can lead to a systemic change of the organization of the state and a reorganization of the *trias politica* or balance of powers. On the other hand, the English state order, as a consequence of the unwritten constitution, does not include a clause like the German constitution, which absolutely safeguards the structure of the state organization, i.e. the structural coordinates of German state organization can not be altered at all, not even if all Members of Parliament vote in favour of an alteration. In Germany, the Federal Constitutional Court to some extent supervises the functioning and working of the state organization and German way of democracy; in the UK, conversely, by not having a constitutional court, the English judiciary, as has just been said, follows political change and does not have the role of ensuring that such change stays within the boundaries of the constitution. See also n. 1128.

1121 See Tomkins, n. 543, p. 106. As regards the conflict of two Acts of Parliament where the later Act has not expressly repealed the earlier one, the doctrine of implied repeal has been developed by the common law. According to this doctrine, the provisions of the later Act prevail over those of the earlier one even where the later one has not expressly repealed the earlier one. Accordingly, Parliament can alter an Act previously passed by enacting a provision, which is *clearly* inconsistent with the previous Act. It is impossible for Parliament to enact that in a subsequent statute dealing with the *same subject-matter* there can be no implied repeal. See Tomkins, n. 543, p. 107, referring to the leading authority on this important aspect of legislative supremacy, *Ellen Street Estates* v *Minister of Health*, (1934) 1 King's Bench Division Law Reports (K.B.) 590, 595–6.

1122 The doctrine of the supremacy of EC law was laid down by the ECJ in C-6/64 – *Costa v ENEL*, n. 824, in which the Court held that by the creation of the European Community 'the Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law, which binds both their nationals and themselves.' This principle was subsequently

The Act of Parliament legislating for the accession is the European Communities Act 1972 (hereinafter ECA).[1123] The most important provisions are set out in sections 2(1), 2(4), and 3(1) ECA.

Section 2(1) ECA gives domestic legal force to all present (at the time of accession) and future provisions of Community law, which are to be given legal effect 'without further enactment', i.e. those provisions, which are directly applicable (Treaty provisions as primary law, which includes the EC fundamental freedoms[1124], and Regulations as secondary law) and/or directly effective (all such provisions, which are sufficiently clear and unconditional to be invoked in litigation before a national court, which may also be Directives and other sources of Community law).[1125]

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amplified in C-11/70, *Internationale Handelsgesellschaft*, n. 238, in which the ECJ held that Community law 'cannot be overridden by rules of national law, however framed.

1123 Which according to the doctrine of legislative supremacy can be altered or withdrawn with a simple majority of the Westminster Parliament, see further *infra*; compare this with Germany where the accession to the European Union is enshrined in Article 23 GG and can thus not be withdrawn save by a two thirds majority in Parliament, Article 79 GG. The ECA reflects the dualistic legal order of the UK, see further chapters 4 and 6 on Germany and the Netherlands.

1124 Because the fundamental freedoms are primarily aimed at the Member States; they, however, also bind the EC itself, see R Streinz, *Europarecht*, 8rd ed., 2008, nos 767 *et seq*. It does, however, not incorporate the fundamental rights protection in the EU as developed by the ECJ as it primarily binds the EC institutions, see Streinz, *ibid*. Community fundamental rights do, however, bind Member States in the context of legitimately restricting EC fundamental freedoms, Streinz, no. 768, with further references. Member States are nevertheless bound by Community fundamental rights when an action of the Member State is initiated or determined by EC law, and then only to the extent that such provisions are mandatory, see ECJ, C-5/88 – *Wachauf* v *Federal Republic of Germany*, (1989) ECR 2609. Only in the case of an exact implementation where national law just repeats what has been mandated by EC law, is the implementing legislation also to be measured against EC fundamental rights. This is the case, for instance, for EC Regulations and Directives, which impose the implementation of minimum standards. As regards the latter, see ECJ, Joint Cases C-20/00 & 64/00 – *Booker Aquaculture*, n. 241. If there is, however, a certain range of interpretations provided for in the Directive, which confers upon the national legislator some leeway with respect to the interpretation and structure of the provisions of the Directives requirements that require implementation, the national legislature acts under its national authority and, thus, the resulting law is in this respect to be evaluated according to the national fundamental rights standard alone. See already chapter 4 on Germany. See also Blanke in Tettinger/Stern, Article 15, no. 38. This is also due to the fact that like Germany, the UK is a dualistic legal system, see already nn. 98, 543, 826, 1123. See also nn. 1132, 1136, 1142, 1257, 1342.

1125 The notion of direct effect was invented by the ECJ in its seminal decision C-26/62 – *Van Gend & Loos*, n. 170, in 1962. The direct effectiveness of a provision does not depend on its source but on its substantive content, which must be sufficiently clear and unconditional. Provisions of Community law that are neither directly applicable nor directly effective but which are nonetheless required by EC law to be brought into force in the national legal systems of the Member States are dealt with for the UK by s. 2(2) of the ECA. This subs. empowers the relevant government Minister to make the necessary provision by means of delegated legislation.

Section 2(4) requires all courts in the UK to construe and to give effect to all legislation (primary and secondary) including Acts of Parliament, whether passed before 1973 or thereafter, 'subject to' the terms of directly applicable and directly effective Community law[1126], regardless of the date of either.[1127]

Since section 2(4) also applies to legislation passed after the accession date, it appears that the Parliament of 1972 attempted to bind its successors and thus to suspend the doctrine of legislative supremacy.

Section 3(1) of the ECA further provides that "[f]or the purpose of all legal proceedings any questions as to the meaning or effect of any of the Treaties or as to the validity, meaning or effect of any Community instruments, shall be treated as a question of law […]."

When something is 'treated as a question of law', this means that the domestic courts have the competence authoritatively to determine it and to adjudicate on disputes arising under it. Thus, Parliament has conferred upon domestic courts in the UK the jurisdiction to hear and to decide cases concerning EC law and if necessary also to set aside (provisions of) an Act of Parliament.[1128]

1126 See in this regard n. 1124.

1127 Combining subs. 2(2) and (4) leads to the result that domestic courts must also construe and give effect to parliamentary legislation subject to any delegated measure made by a Minister under s. 2(2). Such delegated measures must obviously live up to the HRA, which by and large implements the ECHR into the English legal system, see further *infra*. The proper enactment of delegated measure is thus also (incidentally) reviewed by the courts. Section 2(4) of the ECA only states what the courts have always done and this is that all statutes are, if at all possible, to be interpreted by the courts so as to be in conformity and not in conflict with the Crown's treaty obligations including its obligation under the treaties that constitute the European Community. See Tomkins, n. 543, p. 111. The doctrine of supremacy does not prevent the courts from interpreting statutes. When it comes to interpreting a statute in the light of a subordinate EC measure such as a Directive, English courts normally accord a purposive reading to English statutes in order to ensure that English law complies with Community law even where narrower or more literal interpretations of domestic law might have led to a different result. Tomkins, n. 543, p. 112. This is in line with the ECJ's guidance given in C-14/83 – *Von Colson & Kamann* v *Land Nordrhein-Westfalen*, (1984) ECR 1891, where the ECJ ruled that as a matter of Community law, 'in applying […] the provisions of a national law specifically introduced in order to implement [a] Directive […] national courts are required to interpret their national law in the light of the wording and the purpose of the Directive'. This rule of construction, also called the doctrine of indirect effect was extended in C-14/83 – *Von Colson & Kamann* v *Land Nordrhein-Westfalen*, (1984) ECR 1891, in which the Court stated that whenever there is an apparent conflict between the terms of a Directive and those of national law, the national court is, as far as possible, required to interpret the national law in the light of the Directive, regardless of whether the national law was designed to implement the Directive or not, and regardless of whether the national law was adopted before or after the Directive.

1128 Because of the common law doctrine of parliamentary sovereignty, the UK does not possess a constitutional court which would protect the UK constitution even against the parliamentary legislator as does, for instance the German BVerfG. Whereas in the UK, Parliament would

A series of cases summarized as *Factortame* may illustrate the working of the ECA in the context of the doctrine of supremacy.[1129] In *Factortame I* and *II*, it was claimed that certain provisions of an Act of Parliament ('Act') were contrary to EC law and should be set aside accordingly.

The substantive question was referred to the ECJ under Article 234 EC. In the meantime, the applicants sought interim or interlocutory relief to the effect that the relevant provisions of the Act would be disapplied pending the outcome of the substantive question. The House of Lords decided in *Factortame I* that the courts did not have the power to grant interim relief under English law, the effect of which would be to suspend the operation of an Act of Parliament.

The House of Lords, however, considered whether a remedy could be granted under EC law because rights under EC law were claimed to have been compromised by the Act. It referred the question of whether in Community law the courts have the power to grant interim relief the effect of which would be to suspend the operation of an Act of Parliament to the ECJ under Article 234 EC. The ECJ held that the applicants were indeed entitled under EC law to interim protection. Accordingly, the House of Lords eventually granted interim relief by applying EC law (*Factortame II*). The effect of the order however was that the operation of an Act of Parliament was suspended, which raised the question whether granting this remedy could be reconciled with the doctrine of legislative supremacy.

The House of Lords granted the remedy not in its capacity as a court of English law but in its capacity as a court empowered to determine questions of Community law. As the House of Lords was enforcing EC law, legislative supremacy of Acts of the UK Parliament was not interfered with as it has never been a doctrine of Community law but of English law only.[1130] According to the doctrine of legislative supremacy, Parliament may make or unmake any law whatsoever, a power, which it did not lose as a result of *Factortame*. *Factortame* does not suggest that Parliament cannot make a law that is contrary to EC law. The doctrine of legislative supremacy does on the other hand not provide that as

"simply" disregard international treaty obligations if it saw its national fundamental rights standard under threat, in Germany, the BVerfG would, for instance, measure the national implementation of binding provisions of an EC Directive (i.e. provisions not leaving any discretion to the Member States), against the standard of the German Grundgesetz according to its *Solange II* doctrine (see chapter 4 on Germany). See also n. 1120.

1129 *R* v *Secretary of State for Transport, ex parte Factortame (Factortame I)*, (1990) 2 Appeal Cases (A.C.) 85, *R* v *Secretary of State for Transport, ex parte Factortame (No. 2) (Factortame II)*, (1991) 1 Appeal Cases (A.C.) 603.

1130 Tomkins, n. 543, p. 117.

a matter of *Community law* an Act of Parliament cannot be set aside because from the case law of the ECJ, it has always been clear that in a conflict between national law and directly applicable or directly effective EC law, the latter would prevail over the former as a matter of EC law.[1131] As soon as the UK courts became empowered by section 3(1) of the ECA to determine questions of Community law, it was clear from reading the text of the 1972 Act alongside the pre-existing jurisprudence of the ECJ that it was no longer true that nobody in England could set aside an Act of Parliament.

Accordingly, it remains the case that under English law nobody has the power to override or set aside a statute but it is no longer the case that English law is the only law applicable in England. Since 1 January 1973, there have been two legal systems operating in the UK, not one.[1132] The doctrine of the legislative supremacy of statute is a doctrine known to only one of those two systems, i.e. the English one.[1133]

As a consequence of what has been shown in this subsection, if Parliament wanted to enact a statute, which would fall foul of EC law (contrary to section 2(4) ECA) but which it nevertheless wanted to be upheld by the English courts (contra to section 3(1) ECA), Parliament would have two options. The first would be that Parliament withdrew the UK from the EU and repeal the ECA, which albeit rather drastic would not be a problem because national sovereignty is only shared with the European Community for the time being, which is not beyond the recall of Parliament.[1134] The second less drastic option would be that Parliament simply enacted the statute and provided that the Act was to be construed and had effect notwithstanding any provisions to the contrary in either the ECA 1972 or EC law, which would oust the jurisdiction of the domestic courts to enforce EC law over this particular Act and over this particular Act only.[1135] This is because after all domestic courts only held the power to enforce EC law because Parliament has conferred such a power on them, and what

1131 See, however, the *Solange II* case law of the German BVerfG, n. 810 and chapter 4 on Germany, which puts this into question.

1132 Tomkins, n. 543, p. 118. This reflects the dualistic character of the UK legal order.

1133 The doctrine of implied repeal is also not interfered with by *Factortame*. This is, first, because the Act was not in conflict with the ECA but rather with the EC Treaty. The doctrine of implied repeal concerns conflicts between one statute and another and not conflicts between statutes and other sources of law such as the EC Treaty. Secondly, even if the Act was in conflict with the ECA, the doctrine would not apply. This is because implied repeal is about incompatibilities between two statutes, which both deal with the same subject-matter, as was made clear in *Ellen Street Estates*, n. 1121. The two Acts do not however deal with the same subject-matter.

1134 Tomkins, n. 543, p. 120.

1135 Tomkins, n. 543, p. 120.

Parliament can confer on the courts Parliament can take away according to the doctrine of legislative supremacy.

The discussion on the relationship between EC and English law shows, to some extent in parallel to the German BVerfG, that the primacy of EC law (such as in the context of further unbundling legislation) as proclaimed by the ECJ does have (theoretical) limits in both Member States.[1136] The German *Solange* doctrine and the English doctrine of parliamentary sovereignty, however, differ in that the German BVerfG makes it clear that what counts in Germany is the German fundamental rights standard and not any less protective standard (which further unbundling legislation would have to comply with). The English doctrine of parliamentary sovereignty, to the contrary, does not (necessarily) seek recourse in the protection of fundamental rights but simply expresses that it is the political will of Parliament (even if contrary to the UK's Treaty obligations), which limits the primacy of EC law in the UK (such as, for instance, unwanted further EC unbundling measures).

b. Human Rights Act 1998 and judicial review of Acts of Parliament

Another, more recent challenge to the doctrine of legislative supremacy is the HRA, which incorporates the ECHR into domestic law.[1137] The terms of domestic incorporation of the ECHR by the HRA are however significantly different from those contained in the ECA with respect to the EC.

While the UK has been bound by the ECHR as a matter of international law since the early 1960s[1138], the ECHR was not part of English law until incorporated into domestic law in October 2000 with the coming-into-force of the HRA. Between then and 2000, domestic courts could not enforce the terms of the ECHR but only take its terms into consideration when enforcing domestic law.[1139]

1136 Which is also the result of the dualistic legal systems governing both Member States as opposed to the monistic legal order of the Netherlands, see further chapter 6 on the Netherlands.

1137 All Convention rights applicable are specified in an exhaustive list in s. 1 HRA. This does, however, not abolish the common law concept of constitutional rights (which has been criticized for its uncertainty as to what might be recognized by the courts as a 'constitutional right') because the catalogue of Convention rights is not a complete list of all rights known to modern legal systems, which becomes clear if one compares the HRA list of Convention rights with the rather extensive list of rights in the European Charter of Fundamental Rights of the EU. Thus, s. 1 HRA is a codification of certain human rights, which adds to the non-codified judge-made common law constitutional rights in the UK.

1138 Tomkins, n. 543, p. 121.

1139 During this period only the ECtHR could enforce the ECHR in respect of the UK, which is still the case for Acts of Parliament, which are in breach of ECHR.

A similar question to the one above with respect the relationship of the ECA to legislative supremacy is whether the HRA potentially interferes with the doctrine of legislative supremacy in that Parliament might not be free any more to legislate in contravention to the Convention rights incorporated into English law by the HRA.

This relationship is governed by sections 3 and 4 of the HRA. Section 3 reads: "So far as it is possible to do so, primary legislation […] must be read and given effect in a way which is compatible with the Convention rights."

Accordingly, whenever possible courts must interpret enacted statutes so as to be in conformity with Convention rights. Section 4 stipulates that if such an interpretation is not possible, the court may grant a newly created remedy, which is the so-called declaration of incompatibility. With such a declaration the court expresses its view that a certain statute is incompatible with a Convention right, which according to section 4(6) does however "not affect the validity, continuing operation or enforcement of the provision in respect of which it is given." This declaration thus leaves it to Parliament to continue with the statute, to amend it or to repeal it. As the final decision rests with Parliament, it continues to retain the supreme legislative authority to legislate in contravention of Convention rights, which cannot be overturned or set aside by any domestic court, notwithstanding any incompatibility. The doctrine of legislative supremacy is thus not disturbed.

2. DIRECT APPLICATION OF ECHR

As a result of the legislative supremacy of Parliament, which has not lost its absoluteness as a result of the ECA and the HRA, and which cannot be challenged by the English courts, any primary legislation, i.e. legislation initiated and passed by Parliament[1140] can in principle disobey human rights and not be overturned or even set aside or disapplied by the English judiciary.[1141] English courts can only show their disapproval of primary legislation by way of a declaration of

[1140] More accurately Tomkins, n. 543, p. 48. Parliament is not a 'public authority' in terms of s. 6 HRA.

[1141] Tomkins, n. 543, p. 189 (n. 50), however, emphasizes that as "a principle of statutory construction […] Parliament does not lightly intend to legislate so as to be in breach of the Crown's international treaty obligations. If Parliament does so intend, it will make its intentions clear. Where legislation is clearly in breach of international law the courts will give effect to the statute, but where the statute is unclear or ambiguous the courts will endeavour to construe it so that it complies with, rather than is in conflict with, the Crown's international treaty obligations."

incompatibility. Only the ECtHR can decide that the UK is in breach of human rights as protected by the ECHR; according to Article 46 ECHR, such a decision would be binding on the UK and must be complied with for the UK would otherwise be in breach of its international treaty obligations.

Delegated legislation and public authorities

Legislation delegated to the UK Government Minister concerned by primary legislation, i.e. the European Community Act, to implement EC Directives must, as a Statutory Instrument and according to section 2(2) of the ECA in conjunction with section 2(2) of Schedule 2 of the ECA, be laid before Parliament and approved by it according to an affirmative resolution procedure, meaning it must be (affirmatively) approved by both Houses of Parliament.[1142]

Where such delegated legislation is supposed to be merely an exact implementation of an EC Directive[1143], the English courts would review such delegated legislation to the extent that it is *ultra vires*[1144], i.e. whether it is compatible with the HRA 1998, the ECA 1972 (and thus the initiating EC legislation) and EC fundamental rights (see above).[1145]

1142 Rejecting it could mean that if the delegated legislation was a proper implementation of a EC Directive Parliament would explicitly or impliedly repeal in this particular case the powers granted in the ECA and thus in this particular case the ECA itself; by legislating against directly applicable or effective European legislation Parliament would explicitly or impliedly repeal s. 2(1) ECA and thus in such a specific case the ECA itself. This repeal power compares to Article 79(3) GG, which in absolute terms prohibits any change of structure of the German Grundgesetz (see also the accompanying text to nn. 542 and 1340) and is also a reflection of the UK's dualistic legal order.

1143 In the case, however, that delegated legislation implements an EC Directive, which leaves the Member States options for implementation, which would be the case if the Commission's proposals for further unbundling measures were enacted in an EC Directive, English courts (acting as English courts) would review this delegated legislation as they would review purely domestic legislation, i.e. not initiated by EC legislation, on the basis of the ECHR as incorporated into domestic law by the HRA, and (acting as European Courts) review it for compliance with EC primary law, in particular Article 56 EC; the originating EC legislation would be checked against EC law including Community fundamental rights on EC level.

1144 *Ultra vires* delegated legislation means that it is illegal, i.e. not covered by the empowering Act of Parliament, and irrational, see Tomkins, n. 543, pp. 177, 192. The concept of irrationality has developed from the famous (infamous?) *Wednesbury* reasonableness concept, according to which a decision could only be quashed if it was 'so unreasonable that no reasonable authority could ever have come to it' (Lord Greene MR in *Associated Provincial Picture Houses* v *Wednesbury Corporation*, (1948) 1 King's Bench Division Law Reports (K.B.) 223, 230) or 'so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it' (Lord Diplock in *Council of Civil Service Unions* v *Minister for the Civil Service*, (1985) Appeal Cases (A.C.) 374, 410), to a common law doctrine of proportionality, see in more detail towards the end of this section, *infra*.

1145 In which case, a conflict between the ECHR as applied by the HRA and Community law might arise. Since the coming-into-force of the HRA, the English courts have to interpret all

Such a case, however, seems unlikely to happen given that it has been approved by Parliament because such approval would imply that the implementation of an EC Directive by way of delegated legislation was done in accordance with the parliamentary intentions expressed by the ECA. Generally though, according to s. 6(1) HRA, if a public authority such as Government or a sector regulator which is formally independent like OFGEM acts in a way that is incompatible with a Convention right, such an action is *prima facie* unlawful. Actions such as subordinate or delegated rule-making by Ministers could thus be quashed by an English Court as a result of judicial review.

On the other hand, section 6(2) HRA provides that it would not be unlawful for a public authority to act in a way which is incompatible with a Convention right if, as a result of a provision of primary legislation, the authority could not have acted differently. Consequently, if an Act requires a public authority (such as a Minister) to act in a way which is incompatible with a Convention right, such executive action is not unlawful but the provision of primary legislation could of course be declared incompatible with Convention rights according to section 4 HRA. A further, second exception is provided for in section 6(2) HRA according to which it would not be unlawful for a public authority to act in a way which is incompatible with a Convention right if the authority was acting so as to give effect to or to enforce a provision of primary legislation which itself cannot be read or given effect to in a way which is compatible with Convention rights.[1146]

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legislation, even legislation of EC origin, compatibly with the Convention rights (s. 3 HRA) and act compatibly with the Convention rights; as regards the latter, English courts are public authorities under s. 6 of the HRA. See A Dignam, D Allen, *Company Law and the Human Rights Act 1998*, 2000, p. 144. The conflict might arise because the ECJ recognised that at times it may be legitimate to restrict ECHR rights and freedoms to achieve the overall aims and objectives of the EC. See Blanke in Tettinger/Stern, Article 15, no. 11; Dignam/Allen, *ibid*., p. 144. Thus, Community law might prove incompatible with the Convention rights. As a result, the functions of English courts acting as English courts (which have to apply the HRA 1998) and, at the time, acting as European courts (which have to apply EC law under the ECA) might clash. While the English courts have no power to disapply Community legislation because it violates ECHR rights, it could grant interim relief and refer the case to the ECJ according to Article 234 EC to determine the validity of the EC legislation in question. The victim could also bring an action before the ECtHR because English courts can only declare primary legislation incompatible with the HRA and thus the EHCR. If the victim was successful there, the UK would be in a difficult situation facing a *Bosphorus* like situation, see the outline of this ECtHR case in chapter 4 on Germany, n. 824, where it would have to give way to the judgment of the ECJ or the ECtHR. Assuming that the ECJ rules that the EC legislation in question was in line with EC law, thus also rendering UK primary legislation in line with EC law, the Westminster Parliament would have to decide which international treaty obligation it would have to disregard and thus violate: Parliament could either disapply the working of the ECA in the specific case at hand and legislate in contravention to the EC Treaty thus breaching its EC treaty obligations, or it could simply ignore the ruling of the ECtHR and thus be in breach of its ECHR treaty obligations.

1146 The wording here refers back to sections 3 and 4 HRA, which are the provisions that govern the relationship between human rights and legislative supremacy. See in greater detail Tomkins, n.

For the purpose of this work, however, only the ECHR as applied by the ECtHR, more precisely Article 1 of the First Protocol, which protects the right to property, will serve as the standard of review here because the standard of protection afforded by the HRA 1998, whose section 1(1)(b) incorporates the First Protocol of the ECHR into domestic law, is not enforceable for the reason of legislative supremacy.[1147] Consequently, as part of the human rights protection afforded by the ECHR as developed by the case law of the ECtHR, further unbundling measures are to be tested measured at the *fair balance* test developed by the ECtHR.[1148]

IV. FUNDAMENTAL RIGHTS ISSUES ARISING IN CONTEXT OF FURTHER UNBUNDLING LEGISLATION

As just outlined, further unbundling measures to be enacted in the UK would primarily have to be reviewed as to whether they comply with the fundamental right to property as set out in Article 1 of the First Protocol of the ECHR.[1149]

543, p. 190.

1147 The case law of the ECtHR must 'only' be taken into account by the English courts according to s. 2 of the HRA; they are, however, not obliged to follow it. The application of Article 56 EC as primary EC law will also be discussed because English courts in their capacity as European courts under the ECA can disapply any incompatible domestic legislation and thus as a consequence of the ECA enforce overriding EC law even against Acts of Parliament.

1148 Tomkins, n. 543, pp. 188 *et seq.*, 195 *et seq.*; Dignam/Allen, n. 1145, pp. 267 *et seq.* The concept of proportionality is not expressly mentioned in the text of the ECHR but has been developed by the ECtHR in its case law. Thus, because English courts only have to take the ECtHR case law 'into account', they are not compelled to incorporate the doctrine of proportionality into domestic judicial review law. Nevertheless, the House of Lords has in the meantime entirely of its own volition moved to embrace a doctrine of proportionality in English judicial review law thus creating this doctrine in common law. The leading case in this regard is *R (Daly)* v *Secretary of State for the Home Department*, (2001) 2 Appeal Cases (A.C.) 532. See also Horspool in Tettinger/Stern, A V ('Die Anwendung des Human Rights Act 1998 im Vereinigten Königreich'), nos 17 *et seq.*, 19 *et seq.*, pp. 58 *et seq.* Lord Hoffmann in *R (Alconbury)* v *Secretary of State for the Environment*, (2001) 2 Weekly Law Reports (W.L.R.) 1389, no. 76, however, felt that he had to stress the fact that because English courts are not bound by ECtHR case law according to s. 2 HRA, they are also not bound by the proportionality principle developed by ECtHR, in particular if such case law is at odds with the distribution of powers under the British constitution (such as legislative supremacy).

1149 For reasons laid out in the previous section, the freedom of economic activity, mainly in the form of the freedom of contract, and the right to property as protected by common law will not be discussed here. The freedom of economic activity as protected under common law will, however, play a role at section V(2) to the extent that it potentially affords a higher level of protection than the ECHR. Both fundamental rights are of central importance to the common law. As regards the latter, see in great detail R Clayton, H Tomlinson, *The Law of Human Rights*, OUP, 2000, pp. 1292 *et seq.* It however seems that there has never been a clear expression of the right to property as a constitutional principle in the common law. As Allen, pp. 16–7,

1. ARTICLE 1 OF 1ST PROTOCOL ECHR

Article 1 of the First Protocol of the ECHR can be divided in three parts: (1) peaceful enjoyment of one's possessions is the principle and there exists (2) a qualified protection against the deprivation of property and (3) the possibility to regulate ownership. Parts 2 and 3 are the consequence of the general principle expressed in part 1. The three rules are not to be seen as separate parts but as intertwined with each other.

a. Subject-matter of protection

The ECHR contains an autonomous definition of property, i.e. independent of the laws of any of its signatories. In the existing case law, it has become clear that the scope of Article 1 of the First Protocol is rather broad. The most important reason is that the ECHR does not contain a specific right or freedom of economic activity, profession or occupation[1150] so that the ECtHR defines *possessions* (or property) not only as covering legally owned property objects, which includes shareholdings[1151], but also "certain other rights and constitutions".[1152] One precondition surely is that some economic value is involved, i.e. only rights and interests, which can be valued in money, are protected by Article 1[1153]; they must

puts it, the constitutional protection of the right to property applies "only in the most general sense that the State should treat its citizens fairly. In any case, even if there is a general binding principle of fairness in relation to property rights, it is so ill-defined that it is of little practical force. […] Hence, P1(1) [Article 1 of the First Protocol ECHR] does not represent a radical departure from traditional principles. The body of case law under P1(1) is plainly far more detailed than the fundamental law ever was […] (comment in square brackets added)." The protection of the right to property in domestic law has been limited because this right as all fundamental rights in English law, has always been subject to unfettered interference by Parliament. Clayton/Tomlinson, *ibid*., p. 1321, thus claims that Article 1 of the First Protocol ECHR could provide stronger protection. Seeing the protection of property stronger in the UK than guaranteed by the ECtHR, however, Dignam/Allen, n. 1145, pp. 269–70.

1150 Nor does it contain any guarantees such as the German fundamental right of association in Article 9(1) GG with respect to the organizational freedom of associations such as corporate bodies.

1151 ECtHR, *Bramelid & Malmstrom* v *Sweden*, 12 October 1982, Decision and Reports (D.R.) 29, 64, and *Ruiz-Mateos* v *Spain*, 23 June 1993, Ser. A 262.

1152 See, for instance, ECtHR, *Latridis* v *Greece*, no 31107/96, ECHR 2000-XI, no. 54, and *Beyeler* v *Italy*, no. 33202/96 (GC), ECHR 2000-I. See further, T Barkhuysen, M van Emmerik, 'De eigendomsbescherming van article 1 van het Eerste Protocol bij het EVRM en het Nederlandse bestuursrecht', (2003) JBplus 2, 4–5, for an overview of the rights recognized by the ECtHR as possessions. See also ECtHR, *Tre Traktörer Aktiebolag* v *Sweden*, 10 October 1985, Ser. A 159, confirmed by *Fredin* v *Sweden*, 18 January 1991, Ser. A 192, as regards the protection of the economic interest (*betriebliches Vermögen*) in the context of entrepreneurial activity (*Recht am Unternehmen*). The term 'possessions' means the same as the term 'property', see in greater detail, Müller-Michaels, n. 535, p. 64.

1153 See ECtHR, *Beyeler*, *ibid*. Moreover, the right or interest must exist sufficiently certainly, such as the right to use or operate networks.

be based on "legitimate expectations".[1154] The mere expectation of future income does not suffice, however. It can thus be said that Article 1 protects existing rights, which also includes the existing exercise of a profession[1155], and expectations of monetary value which can be substantiated, but not the process of acquiring such rights or expectations.

With respect to the protection of economic interests, private law claims, for instance, are in principle protected by the right to property as long as they exist and can be claimed.[1156] This general rule has, however, been subjected to severe limitations. In *Mellacher*[1157], the Court saw a deprivation of property in the statutory introduction of a system of fixed real estate rents, which led to a reduction in existing real estate rents. The object of protection, however, was not the individual rental claims but the real estate as a whole. The ability to enter into rental agreements was only one aspect of the right to property in land. This right affords its owner different possibilities of use. If every right arising from the realization of each of these possibilities had been interpreted as property, the regulation or the control of use of property as set out in Article 1(2) of the First Protocol would have been deprived of its applicability, which contradicts the purpose of Article 1 as a whole.

b. Deprivation

Article 1 distinguishes between deprivation of (the entire right to) property[1158] and the deprivation of individual components or rights forming part of the right to property.[1159]

The most intrusive interference with the right to property is the deprivation of property or expropriation, which means the forced transfer of ownership either in a legal or in a factual sense resulting in the loss of the right to dispose of or to

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1154 See only ECtHR, *Kopecky* v *Slovakia*, no. 44912/98 (GC), ECHR 2004-IX, *Maurice* v *France*, no. 11810/03 (GC), ECHR 2005-XV, and *Anheuser-Busch* v *Portugal*, no. 73049/01 (GC), ECHR 2007.

1155 ECtHR, *van Marle & Others* v *The Netherlands*, 26 June 1986, Ser. A 101.

1156 Müller-Michaels, n. 535, p. 66; ECtHR, *Stran Greek Refineries & Stratis Andreadis* v *Greece*, 9 December 1994, Ser. A 301-B; European Commission for Human Rights (ECnHR), *Pudas* v *Sweden*, 27 October 1987, Ser. A 125-A, and *Batelaan & Huiges* v The Netherlands, 3 October 1984 Decision and Reports (D.R.) 41, 170.

1157 ECtHR, *Mellacher and Others* v *Austria*, 19 December 1989, Ser. A 169, confirmed in *Pine Valley Developments and Others* v *Ireland*, 29 November 1991, Ser. A 222, no. 56.

1158 Comprising of expropriation and *de facto* expropriation, see *infra*.

1159 Being the regulation or control of the use of property, see *infra*. For the individual components of the right to property, see the Introduction.

deal (or not to deal) with one's property as one pleases.[1160] Deprivation of property can happen in a strictly legal sense but also as a matter of fact if certain measures lead in reality to similar consequences. The latter, which is also named *de facto* expropriation, can according to the case law only be found to occur if a measure renders any sensible use of the right to property impossible or strips property off all its value.[1161]

A less intrusive form of interference is the deprivation of the right to use, let or sell the property[1162] or, in other words, the regulation of ownership without completely removing the right to dispose of the property.[1163]

To draw the line between deprivation and regulation is rather difficult. One important criterion is the exact definition of property or ownership. Appreciating whether a measure such as the withdrawal of permission has the effect of a deprivation, one should not look at the measure in an isolated way but against the background of the entire situation in which such a measure is taken. Where, for instance, all animals of a farmer are killed upon official order because of an animal epidemic but the farmer is still allowed to continue his business thereafter, it is more the economic activity which forms the property rather than his animals. Consequently, killing all the animals is not to be seen as a deprivation but as a regulation of the farmer's property as he is still able to continue his economic activity.[1164]

Further, as has just been said above, the deprivation of private claims or certain competences, for instance, is not necessarily a deprivation of property but can

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1160 ECtHR, *Papamichalopoulos* v *Greece*, 24 June 1993, Ser. A 260-B, and *Brumaresco* v *Romania*, no. 28342/95 (GC), ECHR 1999-VII.

1161 See only ECtHR in *Katte Klitsche de la Grange* v *Italy*, 27 October 1994, Ser. A 293-B, where it states that "[w]here […] the owner retains the ownership subject to restrictions which reduce to virtually nothing the economic value of the use or exchange of the property, this is known as "value expropriation" and gives rise to an entitlement to compensation. This situation arises where the restriction is very severe – absolute prohibition – and where it is imposed for an indefinite period of time or remains in force for longer than is reasonable." See also n. 559.

1162 ECtHR, *Mellacher*, n. 1157.

1163 In *James & Others* v *United Kingdom*, 21 February 1986, Ser. A 98, the Court established that regulating private ownership as part of a socio-economic programme is within the state's margin of appreciation. See Dignam/Allen, n. 1145, pp. 268–9.

1164 See also ECJ, Joint Cases C-20/00 en C-64/00, *Booker Aquaculture*, n. 241, according to which the killing of animals in a similar context was classified as a restriction of ownership rights since the continuation of the economic activity had not been prohibited. It was only because of the measure was taken, the Court claims, that the applicants were actually enabled to continue their economic activity. In ECtHR, *Fredin*, n. 1152, the applicant had to close down one of his gravel pits but the withdrawal of the mining permission did not result in the remaining land owned by the applicant and surrounding the gravel pit being worthless or any sensible use of it having been made impossible. Thus, a *de facto* expropriation was rejected.

also be a deprivation in the form of the regulation of property if these claims or competences form part of a certain right to property, which affords its owner different possibilities of use. Accordingly, the deprivation of, for instance, rental claims or certain competences with respect to the use of private *infra*structure is not an expropriation in the sense of Article 1(1) 2nd sentence but a control of the use of land or real property measured against the standard as set out in subsection 2 of Article 1.

What can thus be generally inferred from the case law of the ECtHR is that private law claims and individual competences with respect to property are only protected as rights to property under Article 1 of the First Protocol if they are not merely ancillary to the right to property in the principal object for protection.

c. Margin of appreciation and fair balance

The right to property is not an absolute fundamental right but can be subject to restrictions if justified. The Court's requirements to justify such a restriction are similar for all forms of interference with the right to property, may it be deprivation of property in the form of (*de facto*) expropriation or its regulation.

First, the Court checks whether the interference is in accordance with the principle of lawfulness of state action. The interference must thus be based on legislation[1165] and sufficiently accessible, clear, precise and predictable.[1166] As this does not usually lead to the finding of a violation of ECHR rights, this principle also finds its way into the Court's specific proportionality test[1167], more properly called the fair balance test, which is outlined in the paragraph after next.

Secondly, the Court scrutinizes whether the interference can be justified by the general interest. The ECtHR affords its signatories a rather broad margin of appreciation when it comes to the question of whether a general interest can justify the interference.[1168] The Court thus only rarely reaches the conclusion that a certain infringement of ownership does not pursue legitimate objectives of general interest even though the Court does review the reasons given by the state

1165 ECtHR, *Scordino* v *Italy*, no. 43662/98, ECHR 2007, nos 87–94, with references to earlier case law.

1166 ECtHR, *Beyeler*, n. 1152, no. 109, *pacek* v *Czech Republic*, no. 26449/95, ECHR 1999, and *Belvedère Alberghiera* v *Italy*, no. 31524/96, ECHR 2000-VI.

1167 ECtHR, *Beyeler*, n. 1152, no. 10, referring to legal certainty aspects of the law and to the latitude afforded to authorities by the law to be taken into account when assessing whether a measure complained of struck a fair balance.

1168 ECtHR, *James*, n. 1163.

for the restriction and examine whether they are relevant and sufficient.[1169] This is because the Court considers national authorities best equipped to know about the needs of their society in order to establish what is necessary in the general interest.[1170] Only in exceptional cases does the Court come to the conclusion that the interference did not serve any objectives of general interest.[1171] This has only happened in evidently unreasonable cases.[1172]

Thirdly, the ECtHR assesses whether the interference is proportionate to the legitimate aim pursued or, more accurately, whether there exists a fair balance between the requirements of the general interest and the protection of the fundamental rights of the individual (victim or applicant).[1173] The principle of proportionality thus attempts to achieve a fair balance between individual and community needs. Both the principle of proportionality and the margin of appreciation are complementary in operation.

Fair balance is lacking when a disproportionate or excessive burden is imposed on the victim. From the case law of the ECtHR, it can be inferred that this assessment is the most important test for determining whether Article 1 of the First Protocol of the ECHR is violated.[1174] The tests of whether an interference

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1169 See, for instance, ECtHR, *Holy Monasteries* v *Greece*, 9 December 1994, Ser A 301-A.

1170 T Barkhuysen, M van Emmerik, De eigendomsbescherming van artikel 1 van het Eerste Protocol bij het EVRM en het Nederlandse burgerlijk recht: het Straatsburgse perspectief, Preadvies Vereniging voor Burgerlijk Recht, 2005, p. 67. This is why Dignam/Allen, n. 1145, pp. 268–70, claims that property protection under domestic courts would give more protection than the ECtHR.

1171 The ECHR does not distinguish between various types of general interest, i.e. whether they are of economic or non-economic nature, but such a distinction does play a role within the justifications of impediments to EC fundamental freedoms such as Article 56 EC, see R Streinz, *Europarecht*, 8rd ed., 2008, no. 833.

1172 See, for example, ECtHR, *Zwierzynski* v *Poland*, no. 34049/96, ECHR 2001-VI. See in this respect for a critical view, Dignam/Allen, n. 1145, pp. 268–9. Dignam argues that the level of discretion afforded to the state by domestic courts is unlikely to be as wide as the Strasbourg court would accord, i.e. to be as deferential to factual assertions of the state in realtion to the balancing of private and public interests and the respective merits of each.

1173 The proportionality test of Article 5(3) EC as applied by the ECJ is not applicable here because it only applies to measures of Community institutions. Here a national measure is under scrutiny, whose compatibility with, inter alia, primary EC law is assessed. The ECJ will not be concerned with these measures apart from, possibly, in the context of a preliminary ruling according to Article 234 EC, and will thus not be able to decide on EC measures in this context so that it is not able to apply the EC standard of proportionality, which at least in theory appears to be stricter. See in greater detail, Part 1 Chapter 3 and chapter 7 on the European Union.

1174 The structure of the ECtHR's proportionality test is not the same as the structure of the German and the EC proportionality tests (with respect to a comparison with the German style test, see Müller-Michaels, n. 535, p. 84, which consist of evaluating the appropriateness or suitability of a measure to achieve a general interest objective, its necessity (or whether milder, less intrusive but equally effective means exist) and the actual proportionality or the weighing

with fundamental rights is "based on legislation" or "in the general interest" are rarely an obstacle.

An important feature of the fair balance test is also what someone whose right to property is at issue should legitimately expect from legislation. The owner of a company, for instance, should base its expectations not only the profitability of its property but the owner should also take into account any (foreseeable) restrictions resulting from legislation.[1175]

The proportionality test is also the place where compensation is considered for any losses incurred as a result of the interference with someone's right to property. It is the *rule* that compensation is to be paid. The amount to be paid depends on the nature of the interference. As regards the deprivation of property in the form of (*de facto*) expropriation, the basic assumption is that compensation equals the full market value.[1176] By contrast, in the case of regulating ownership, the regulation of ownership rights without payment of compensation is not necessarily perceived as a disproportionate burden.[1177] This can also be inferred from Article 1 of the First Protocol of the ECHR itself where the regulation of property is in principle permissible. Whether compensation is required depends on the circumstances of the individual case. The graver the consequences of the

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or balancing of general with private interests. However, for the sake of comparability, a structure similar to the German and EC proportionality tests is applied here.

1175 ECtHR, *Fredin*, n. 1152, and *Pine Valley Developments*, n. 1157. The predictability of a state measure is part of its legality and requires, for instance, proper warning and consultation before enforcement of such a measure whereas legitimate expectations are about the reliance on the continuation of the original use of property for a certain purpose or to what extent its regulation or even deprivation was foreseeable at the time when the use for such purpose began.

1176 ECtHR, *Holy Monasteries*, n. 1169.

1177 However, where regulation causes an excessive burden to certain individuals, an obligation to offer at least some compensation can follow, see the judgement of the Dutch Hoge Raad (HR), LJN: AD5493, C00/142HR, 16 November 2001, (2002) AB 25, in which it refuted an earlier judgement of the ECtHR, see J Hoitink, *De ontbrekende schakel – Een beschouwing over eigendomsbescherming als fundament voor schadevergoeding*, 2006, p. 34. This to some extent resembles the outdated so-called "Schwere" (ponderosity) oder "Sonderopfer" (special sacrifice) theory of the BVerfG and the civil law courts in Germany, according to which a deprivation of property was widely construed in that regulation restricting rights to private property could also mean a deprivation if demanding a special sacrifice. The case law of the BVerfG has, however, changed towards a formal definition of expropriation (as one type of deprivation), see in greater detail the discussion in chapter 4 on Germany, which uses the above mentioned theories only to assess whether the regulation (*Inhalts- und Schrankenbestimmung*) of private property can, without being a deprivation, be regarded as exceeding the *Sozialbindung* (the legitimate use of private property to further the general interest) thereby imposing a disproportionate burden on the property owner. In this respect, see the German BVerfG in *re Rheinland-pfälzisches Denkmalschutzgesetz*, n. 551, discussed in greater detail in chapter 4 on Germany. See more generally, Papier in Depenheuer, n. 886, pp. 93 *et seq*.

interference, the more likely it is that compensation has to be offered in order to create a fair balance.[1178] On the other hand, the general interest can justify the payment of less compensation.[1179] The Court always focuses on the question of the disproportionately of the burden and whether opposing interests, of which the main one is the level of compensation, are sufficiently in balance. Deprivation of property without compensation is only permissible in exceptional cases.[1180]

This compares to the position in Germany where in the case of expropriation compensation must *per se* be provided for.[1181] This is a consequence of the formal definition of expropriation applied there, which only refers to the forced transfer of property.[1182] The extent of interference and the consequences for the ownership position does thus not matter in Germany, whose law differs from the ECHR because deprivation of property according to Article 1 of the First Protocol does not only mean a deprivation in a formal sense where property is being transferred but also any measures, which achieve similar effects and consequences *de facto*.[1183] This means in consequence that the interference must in fact be such that the right to dispose of the property is lost.[1184]

Coming back to the ECHR fair balance requirement, the fact that there are less intrusive alternative measures, which can in the situation at issue lead to a similar

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1178 ECtHR, *Chassagnou & Others* v *France*, nos 25088/94, 28331/95, 28443/95 (GC), ECHR 1999-III. See in greater detail *infra*.

1179 In *Scordino*, n. 1165, the ECtHR lists earlier jurisprudence in which different types of general interest justify less than market value compensation, such as in, for instance, ECtHR, *James*, n. 1163, *Lithgow* v *United Kingdom*, 8 July 1986, Ser. A 102, *Kopecky* vs *Slovakia*, n. 1154, *Broniowski* v *Poland*, no. 31443/96 (GC), ECHR 2004-V, *Von Maltzan & Others* v *Germany*, nos 71916/01, 71917/01, 10260/02 (GC), ECHR 2005-V, *Jahn & Others* v *Germany*, nos 46720/99, 72203/01, 72552/01, (GC) ECHR 2005-VI, and *Papachelas* v *Greece*, no. 31423/96 (GC), ECHR 1999-II.

1180 See, for instance, the recent example in re *Jahn*, *ibid.*, where the Court considers "that in the unique context of German reunification, the lack of any compensation does not upset the "fair balance" which has to be struck between the protection of property and the requirements of the general interest."

1181 Similar to the position in the Netherlands with respect to the right to property according to Article 14 Grondwet, see Hoitink, n. 1177, p. 39.

1182 See n. 1177.

1183 See ECtHR, *Sporrong & Lönnroth* v Sweden, 23 September 1982, Ser. A 052 (Court Plenary); on the other hand, de facto deprivation of property is to some extent comparable to the German construct of regulation of ownership (*Inhalts- und Schrankenbestimmung*), which exceptionally comes close to expropriation and thus can also entail the obligation to provide for compensation, see the accompanying text to n. 889, in particular the decision of the German BVerfG in re *Denkmalschutz*.

1184 This is only the case if any sensible use is made impossible, or if the property is dispossessed of all its value, see already *supra*. For instance in ECtHR, *Elia* v *Italy*, no. 37710/97, ECHR 2001-IX, this was not the case because the applicant was not prevented from entering his land, his control over the land was not lost entirely, and albeit that it was more difficult, he still retained the power to sell the land.

result, is not a decisive consideration for deciding the question of whether the contested measure is justified as long as it is not evidently unreasonable.[1185] Possible alternatives may, however, play a role in the context of determining whether a fair balance has been struck when choosing the contested measure.[1186] The severity of the interference plays an important but not decisive role because it must be measured against the interest which the State is pursuing. Sometimes, there are additional circumstances, which can play a role in deciding whether a measure is disproportionate such as procedural guarantees with respect to the interference[1187], the predictability of the interference[1188] or the question of compensation.[1189]

2. SUBJECT OF PROTECTION

The primary target of further unbundling legislation in the UK with respect to energy transmission networks (either based on EC Directives or purely domestic) would be the two private vertically integrated electricity supply undertakings in Scotland.

Further, National Grid as the national gas transmission network owner and operator and electricity transmission network owner in England and Wales and GB electricity network operator might wish to expand into energy generation and supply and apply for the corresponding licence(s). This would mean that its licence restrictions in this respect had to be lifted. Should OFGEM refuse this, which would be likely, then National Grid would be subject to an interference with its right to pursue an economic activity resulting from the application by OFGEM of its competition law enforcement powers deriving from s. 3A of the Electricity Act 1989 as amended. Such a decision by OFGEM would eventually be subject to judicial review and could theoretically be quashed. Thus, some brief discussion of the main issues in this respect is called for. Before looking in greater detail into how far further unbundling measures might conflict with Article 1 of the First Protocol to the ECHR, the question of who is protected, or in ECHR terms who is or can be the victim of state interference, requires clarification.

1185 Hoitink, n. 1177, pp. 34 *et seq.*

1186 It usually only influences the amount of compensation to be paid (instead of the state measure being struck out as disproportionate) where the fair balance or proportionality test shows that milder (and equally effective) means were available to achieve the general interest objectives.

1187 See, for instance, ECtHR, *Beyeler*, n. 1152, and *Kirilova & Others v Bulgaria*, nos 42908/98, 44038/98, 44816/98, 7319/02, judgment 9 June 2005.

1188 See, for instance, ECtHR, *Fredin*, n. 1152, and *Pine Valley Developments*, n. 1157.

1189 See, for instance, ECtHR, *Străin* v *Romania*, no. 57001/00, ECHR 2005-VII, and *Plakatou* v *Greece*, no. 38460/97, ECHR 2001-I.

The obligation of the State to refrain from certain interferences with the right to property applies to natural as well as to legal persons. In *Agrotexim* vs *Greece*, the ECtHR states that

> "[…] the Court considers that the piercing of the "corporate veil" or the disregarding of a company's legal personality will be justified only in exceptional circumstances, in particular where it is clearly established that it is impossible for the company to apply to the Convention institutions through the organs set up under its articles of incorporation or – in the event of liquidation – through its liquidators. The Supreme Courts of certain Member States of the Council of Europe have taken the same line."[1190]

It is thus not the rule but an exception to disregard the legal personality of a company as corporate body. This is also the case in the jurisdictions under review here, i.e. under English[1191], Dutch (see below) and German law (see above with respect to the protection granted under the GG), and also in EC law according to the case law of the ECJ. There, the legal person of the company is dealt with separately from its shareholders. However, it is the national company law as sub-constitutional law which determines what constitutes a corporate legal person. This means that as long as the constitutional laws of these countries are complied with, the coordinates for the establishment and the organization of such corporate

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1190 ECtHR, *Agrotexim*, n. 905, no. 66, at least in cases where a breach of Article 1 of the First Protocol ECHR is claimed, see Dignam/Allen, n. 1145, pp. 182, 190–1. Compare this more recent approach to the earlier approach expressed in cases such as *Pine Valley Developments*, n. 1157, nos 40–3, where the corporate veil was disregarded because the corporate personality was just seen as an artifical vehicle through which majority shareholders conducted their own business. It appears that the ECtHR's model of the corporate entity is not so much "focussed on the preservation of the collective rights subsumed into the corporate form" but rather recognizes the individual rights within the collective, see Dignam/Allen, n. 1145, pp. 190–1, raising issues, which are also relevant in the context of Article 9 GG, see chapter 4 on Germany. Thus, it seems that the ECtHR does at times not distinguish between the company's property and the property of the shareholder(s). Accordingly, any interference aimed at the property of the company will violate the company's rights under the ECHR *as well as* those of the shareholders (where possible according to Article 34 ECHR read in conjunction with Article 1 ECHR).

1191 The *Agrotexim* approach to respecting the corporate veil substantially resembles the domestic UK position. Whereas in *Salomon* v *Salomon & Co.*, (1897) Appeal Cases (A.C.) 22, it was clearly established (and has remained good law ever since) that a company is a legal person in its own right, which is a legal entity separate from that of its members, allowing the company to hold property in its own right, *Foss* v *Harbottle*, (1843) 67 English Reports (E.R.) 189, established the rule that the internal power structure of the corporation is focused on the corporate exercise of power rather that the individual shareholders' exercise of rights. This, however, also means that companies decide their own policies and settle their own disputes by majority decision, see *Cooper* v *Gordon*, (1869) L.R. 8 Eq. 249 (Law Report Equity Cases). See in greater detail, Dignam/Allen, n. 1145, pp. 176–7.

legal persons can be adapted.[1192] On the other hand, if, as is the case with the British energy supply undertakings holding vertically integrated electricity network undertakings which are subject to further unbundling legislation, an undertaking possesses the status of a legal person according to national law[1193], it does in principle enjoy the protection offered by Article 1 of the First Protocol of the ECHR.

V. APPLICATION TO FURTHER UNBUNDLING MEASURES

The basis for the following discussion is the Commission's proposals (as outlined in the Introduction) for revised Electricity and Gas Directives tabled in September 2007. As these Directives afford the Member States a choice, the further discussions focus on the question whether one or all of the options proposed comply with the UK fundamental rights standard in the form of the ECHR. Only the two options are relevant here, i.e. not including the "Third Way" proposed under the lead of France and Germany, because only these would change the situation of the energy supply industry in GB, which is almost completely vertically separated since electricity sector privatization and the voluntary divestiture by British Gas of its gas pipeline system.

1192 EC law must obviously also be complied with, and in particular the fundamental freedoms of establishment and to provide services, Articles 43 *et seq.* and 49 *et seq.* EC must be observed. In particular in the area of these freedoms, legal persons established in the EU are treated in the same way as natural citizens of the EU Member States. See T Oppermann, *Europarecht*, 3rd ed., 2005, § 18 nos 46 *et seq.*, § 26 nos 8 *et seq.*, in greater detail on these freedoms and the far-reaching and ever-growing harmonization in the area of company and corporate law, also on the European company *Societas Europaea* (SE). The establishment of legal persons takes place according to national law, and their organization is thus primarily subject to national regulation. Legal persons can thus be said to be citizens of the Member State they are established in with their constitution being national in nature. Company law is a form of regulation of the fundamental right to property. The adaptation of national company law appears to fall into the sole remit of the Member States, which according to Article 295 EC are responsible in principle for the rules governing the system of property ownership in their territory, subject to compliance with EC law. In this respect, see already Part 1 Chapter 3 section V.

1193 In Great Britain, the legal forms of private limited and public limited companies (Ltd and plc), in which the holding companies of the vertically integrated energy network operators are incorporated (Scottish Power Ltd and Scottish and Southern Energy plc), fulfil the prerequisites of legal personality, see the Companies Act 2006, necessary in the context of the application of the ECHR. Corporate entities or (public or private) limited companies are a body corporate separate from its incorporating shareholders, i.e. an independent institution with its own organization and competences.

1. FURTHER UNBUNDLING IN SCOTLAND

As has already been indicated above, further unbundling of the electricity transmission networks in Scotland could either be the consequence of either a new EC Directive or be pursued by the UK of its own volition and either by way of complete ownership unbundling or by enlarging the powers of the independent system operation pursued by National Grid.

The implementation would be likely to happen by amending the Electricity Act 1989, i.e. either by prescribing that transmission (owner) licensees, i.e. the two vertically integrated Scottish electricity transmission network subsidiaries, which do not operate their electricity networks, would not be allowed to be part of a group of undertakings, which also pursues other energy supply related activities such as electricity generation and supply, or by laying the basis for a further transmission licence amendment, granting the GB transmission system operator further powers including investment decision and tendering powers, and in turn taking such powers away from the transmission (owner) licensees.[1194]

Such amendment would either be enacted by way of a statutory instrument drafted by the government minister responsible and approved by Parliament (when implementing an EC Directive according to the ECA 1972) or by way of an amending Act of Parliament if further unbundling is enacted on the UK's own initiative.

a. Ownership unbundling of electricity transmission

The proposal of the Commission for complete ownership unbundling as translated into the UK situation would prohibit the Scottish electricity transmission network owners from being part of a vertically integrated energy supply undertaking pursuing commercial activities such as generation, supply or the trade of electricity and gas. This would mean that the two Scottish undertakings holding transmission network ownership subsidiaries would have the choice of either selling their network ownership interests or their competitive activities to third parties outside the current vertically integrated holding structure, who must also have different ultimate shareholders; a similar "choice" would exist for the shareholders of the

[1194] Currently, NGET and the two TOs develop investment plans; NGET, when it requires investments to be made, applies for construction to the TO concerned. OFGEM resolves disputes and can thus, in theory, order certain investment to be executed/constructed, see SO/TO Code (in the form of 31 July 2007), section D, Part 1(2) and Part 2. Critical on this procedure, The Brattle Group, 'International Review of Transmission Planning Arrangements – Report for the Australian Energy Market Commission', October 2007, pp. 62 *et seq.*, 71; Moselle, n. 1107.

Scottish undertakings when (forced to) sell one of the two shareholdings after a possible share split.[1195]

Since the relevant undertakings are already pursuing the competitive activities, or, in other words, the rights to pursue an economic activity are already exercised, it is clear that ownership unbundling would interfere with existing economic rights and interests of the energy supply undertakings concerned and that these represent a sufficiently certain economic value.

The competitive activities are legally owned by the vertically integrated energy supply undertakings as are the electricity transmission networks.

Surrendering the competitive activities in the course of executing ownership unbundling would thus result in a deprivation of property in the form of a straightforward expropriation of commercial property *and* of an economic activity. Similarly, surrendering the ownership of the networks would also be a deprivation of property in the form of an expropriation.

It is questionable though whether ownership unbundling can be interpreted as a deprivation of property at all in the sense of forced transfer of ownership in a legal sense because ownership unbundling as demanded by the Commission does not require the surrender of a specific property, which thus results in a specific deprivation; on the contrary, as just described it leaves the owner the choice of the activity to be sold. The only thing the demand for ownership unbundling makes clear is what is not allowed to happen, which is that the network property remains part of a group of companies in which other group companies generate electricity or supply energy. Ownership unbundling can equally be fulfilled by selling the competitive activities or the network property.

However, the sale or transfer of property to third parties is indeed to be regarded as deprivation of property under the ECHR never mind that it is not a forced transfer of property to the State. This is because the transfer is mandated by a state measure and not based on free will; the fact that there is a choice between alternatives is not relevant because in the ultimate analysis, one or the other property must be surrendered, all of the alternative choices leading to a deprivation of property.

[1195] This alternative will not be discussed further but the position of the shareholders will nevertheless be mentioned when establishing whether rights protected under the ECHR are interfered with.

This view is supported by the ECtHR according to which it seems to suffice that the State has ordered the sale in order to invoke Article 1 of the First Protocol of the ECHR in a case like this. This can be inferred from *Kanala* (a case of sale by compulsory auction) where the ECtHR states[1196]:

> "The applicant's ownership share in the real property in issue was transferred to the other co-owner in the context of execution proceedings brought with a view to obtaining sums of money which the domestic courts had earlier ordered to be paid to the applicant's creditor. Even if the interference in question did not involve an expropriation by the State, the contested measure resulted in deprivation of the applicant of his property. The Government has not contested that there was a deprivation of property within the meaning of the second sentence of Article 1 and the Court will accordingly examine it under the "rule" set out in that provision."

The Court thus establishes that an order for execution by a judge can not be regarded as an expropriation by the State but nevertheless leads to a deprivation of the applicant's property.[1197]

To sum up, ownership unbundling is to be classified as deprivation of property rather than a deprivation of the right to use, control, let or sell (regulation of ownership). The property protected here is either the commercial property and economic activity or the legal ownership of the networks. In both cases, the deprivation of property takes place as a straightforward expropriation.[1198]

As the property transfer is enforced by a state measure, i.e. by the relevant legislation, and has thus been ordered by the State, the State can be held responsible for the deprivation of property. In principle, the UK would therefore have to make provision (in or by law) for just compensation.[1199]

1196 ECtHR, *Kanala* v *Slovakia*, no. 57239/00, ECHR 2007. The applicant's complaint was actually successful in that the forced sale was out of fair balance because the consideration was much lower than the market value.

1197 The German terminology in this respect is that any transfer of the property forced by or on the basis of legislation either to the State or to (private) third parties (subject to observing the further requirements of Article 14(3) GG) is to be regarded as expropriation; *de facto* expropriation as a further form of the deprivation of property under the ECHR would be classified as the regulation of property in Germany, possibly being treated similarly to an expropriation under the special requirements set out by the BVerfG in decisions such as in re *Denkmalschutzgesetz*, see further n. 551, and accompanying text.

1198 As already mentioned *supra*, Article 1 of the First Protocol is extensively interpreted by the ECtHR. In Germany, the protection of the right to property according to Article 14 GG is unlikely to cover the economic activity as well; rather, this would be covered by the freedom to take up and pursue an occupation protected according to Article 12 GG.

1199 See further *infra* where the proportionality of further unbundling measures is discussed. If ownership unbundling was imposed unilaterally, i.e. without preceding EC legislation, the UK would not only have to provide for just compensation but also be liable to pay such compensation

b. "Deep" Independent System Operator

The alternative proposal of the Commission for introducing Independent System Operators (ISO) with investment decision and commissioning powers (subject to approval by the regulatory authorities)[1200] as translated into the UK situation would confer greater powers upon NGET, the GB electricity transmission system operator, in that it would become solely responsible for investment planning and decisions, requiring OFGEM's approval because such investments would become part of the regulatory asset base, on which the network charges are based. If the owners of the Scottish electricity transmission networks were not prepared to execute the investment ordered by NGET themselves (under the terms set by NGET), NGET would solely be able to put such investment out to tender to the market.[1201] The owners would be downgraded to mere market participants and investors in their own grids. They would not only not be able to decide about investments in their own grids, they would also be compelled to accept investments by third parties in their grids.

Thus, further unbundling in the form of forcing network owners to also surrender their investment decision (and tendering) powers over their networks to the existing GB electricity transmission system operator must also be classified as deprivation of property in the form of a *de facto* expropriation of network property[1202], rather than a deprivation of the right to use, control, let or sell (regulation of ownership). Although it would "merely" transfer one property competence amongst several (use and control were already transferred to NGET in the course of introducing BETTA) to NGET and thus on the face of it a

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out of its own budget. If the UK, however, imposed ownership unbundling following corresponding EC legislation, the EU would be likely to be liable for full compensation out of its budget, see further chapter 7 on the European Union.

1200 The idea behind introducing a "deep" ISO is that without it the problem of strategic investment withholding is supposed not to be adequately addressed. The strategic investment withholding argument claims that vertically integrated utilities have insufficient incentives to invest in interconnector capacity in order to hold off competition from abroad. Strategic investment withholding is the connecting element between electricity generation and network investment. It is assumed that only a "deep" ISO guarantees the severance of this connection by transferring the right to decide on network investment from the TO to the ISO. On the one hand, the additional power of the "deep" ISO to put an investment out to tender avoids the need for the State to compel the TO to invest, and it would still counter the problem of strategic investment withholding. On the other hand, tendered investment causes legal complications for investments, which are to take place on existing networks, such as the upgrade of existing lines. This is particularly true for with respect to ownership, governance, revenue allocation and liability issues. See in more detail, Brunekreeft n. 9.

1201 On the other hand, an ISO putting an investment out to tender would uncover whether such investment is sufficiently economical to be implemented.

1202 This would be against the trend because it seems that the ECtHR normally does not follow such claims, see Müller-Michaels, n. 535, pp. 75–6.

deprivation in the form of regulation, there is now a complete loss of control, which leaves the legal right or title to the network ownership as an "empty shell" (with the formal right to sell the property as a mere relic of the ownership right). One of the most important competences of legal ownership is taken away, i.e. the decision to deal with one's property freely, which includes the competence to use or not to use one's property as one pleases. The owner is left with the mere physical property without being able any longer to decide about its use or non-use or to decide any more whether to permit certain uses and users.

For the vertically integrated energy supply undertakings, which own the networks, there would no sensible alternative use of the network property be left; sensible use of the networks can only be made by those who actually dispose of the networks (which includes operation and investment decision powers). The current network owners would lose every aspect of their ability to deal with the networks as their own (apart, obviously, from selling it), and in particular the ability to decide (at least jointly with others) about network investment. The TSO can order the network owners to do everything it requires to operate the grid including the maintenance of "their" grid. The network owners are downgraded to mere and exchangeable providers of service on their own grids, which does not give them any economically beneficial use of their property but only out of their economic activity as service provider.

The loss of use and control of the networks are the decisive factors for the determination of the value of the network property. The right to use property for one's own purposes, which is *the* fundamental function of property (apart from serving the general interest (social function)), would be converted to a mere right to receive a mere monetary consideration in return for putting property at the disposal of the ISO, which is in any event determined by the regulator.[1203] The regulated nature of this return further contributes to the almost complete devaluation of the network assets.

In the current context, there would not even be a fair conversion to a mere monetary consideration, which might in itself (if fair) be considered to be a sufficient (sensible) alternative use of the networks. There would also be a deprivation of the last major right, i.e. to decide what to do with one's property, or what *not* to do with it. This "negative" right is part of the right to property and in this context means the "negative" freedom *not* to invest.

[1203] The owners charge the operator for the services they have rendered on the basis of charging methodology approved by the sector regulator OFGEM; a specific network lease or rental fee is not charged, see Special (Licence) Condition J2, which is based on Schedule 10 of the SO/TO Code as amended. In greater detail on the relationship between the transmission owners and the system operator, see The Brattle Group, n. 1194, pp. 55 *et seq.*

It can also not be argued that the preservation of the value of the network property constitutes a sensible alternative use of the network property. This is because assuming that the book value of the network assets remained on the balance sheet of the legal network owners, their trading value is lost for the reasons set out above; if, for accountancy reasons, the assets appeared in the balance sheet of NGET, this would be a further indication that the introduction of this further unbundling measure should be considered as a deprivation as opposed to a regulation of property.[1204]

c. Margin of appreciation and fair balance of further unbundling

As outlined above, the legislative measures just discussed have to be justified by the general interest objectives pursued by the UK legislature and to pass the fair balance test of the ECtHR, i.e. to be proportionate.

As regards the first, i.e. the general interest justification of a state measure, it needs to be recalled, is interpreted such that a state intervention is only declared illegal in cases where the State has evidently overstepped its wide margin of appreciation with respect to whether a general interest justifies the interfering state measure, or in other words if the motives of the state for pursuing certain measures are manifestly unreasonable.[1205]

With respect to the fair balance or proportionality test, it is submitted and has also already been discussed in some detail in Part 1 Chapter 2 (proportionality of competition law enforcement) and Part 2 Chapter 4 (on Germany), that as part of the balancing of the general with the private interest of those targeted by the state measure, a social cost and benefit analysis would contribute to a comprehensive balancing by inquiring from an economic point of view whether, on balance, the measure in question benefits or costs society. Such an analysis would also have to be unambiguously positive in order to justify such a measure. This is because the legislature must endeavour to obtain a thorough knowledge of the consequences of the measures it is intending to implement, which in this context also means that it has to inform itself thoroughly about the costs and benefits of the measure envisaged for society. Only if such an analysis is unambiguously positive can the legislator be confident that the envisaged interference with private interests is in

1204 The issue of in whose balance sheet the assets would appear bears some resemblance to the Dutch analysis, see *infra* chapter 6 on the Nehterlands.

1205 The degree of reasonableness of the general interest becomes relevant when weighed against the private interests of the complainant in order to find out whether a fair balance has been struck between the general interest and the private interest, or, in other words, whether the measures taken are proportionate to the aims pursued.

fair balance or proportionate to the objectives of general interests it is aiming to achieve.[1206]

Margin of appreciation

Starting with the margin of appreciation, there is no cause for doubt that in principle the general interest argument for introducing further unbundling legislation includes legitimate aims. The Commission pursues the establishment and promotion of an internal market for energy supply (greater market integration), the promotion and protection of competition in energy supply throughout the EU and the safeguarding of supply security and reliability; in order to achieve all these aims, and to achieve them for the benefit of the consumer, sufficient investment in energy transmission and interconnection network capacity is considered a *sine qua non* condition by the Commission.[1207] All of these are also aims pursued (and largely accomplished) by the UK, partly as a result of being a member of the European Union; Union-wide competition and the creation of an internal market are part of the UK's general interest as a result of implementing EC law through the ECA 1972.

Further unbundling of the energy supply undertakings aims at safeguarding the structural independence of the network operations and related thereto increasing the transparency of the energy markets, which is considered to contribute to the achievement of the above objectives of the general interest.

Fair balance or proportionality test

For the two legislative measures discussed above not to be in breach of the fundamental right to property according to Article 1 of the First Protocol of the ECHR, they need to strike a fair balance between the State's objectives in the general interest and the private interests of the vertically integrated energy supply undertakings which are subject to these two measures.[1208]

1206 If there are strong indicators that show that any further state measure is not likely to deliver any significant additional benefit, this would already affect the suitability of the measure to achieve the general interest objectives. It is thus argued here that if this was the case further impairment of private fundamental rights would indeed have to be considered to be out of fair balance or disproportionate.

1207 See Part 1 Chapter 1. See also the Recitals (motives) of the 2003 Energy Directives and of the proposals of the European Commission of 19 September 2007, n. 15; in the context of the latter, see their *Explanatory Memorandum*.

1208 See for details of the proportionality test, Part 1 Chapter 2, which is in principle also applicable here. Some issues are nevertheless expanded upon in the specific context of the GB energy sector.

The measures have to be suitable to achieve the general interest aims. On the face of it, both measures assist in achieving the objectives laid out before, by disintegrating the natural monopoly of electricity transmission or at least separating it more thoroughly in order to achieve greater independence of the natural monopoly and thus equal competition conditions for everyone participating in the market. However, it has been observed that separating the networks from electricity generation implies that the coordination of investment decisions of power plants and networks is no longer carried out as an internal process within one firm (i.e. "firm-internal"). Instead, external market coordination would have to take over, which might lead to non-optimal investment, in particular in electricity generation but also as regards the energy networks.[1209] Further, with respect to network investment, although it is true that conferring upon ISOs investment decision authority would address concerns that a TO with generation ownership could under-invest to block competition[1210] and help to limit the asymmetry of information that would otherwise tend to favour the TO and its affiliates over other market participants, there is, however, also the potential for inefficient distortions. For instance, network investments can often reduce operating costs. But if the ISO is incentivized to reduce its operating costs it might do so by requiring inefficiently high levels of investment by the TO. Minimising these distortions would require careful work in designing the ISO/TO interface and regulatory oversight[1211], which would require high regulatory involvement and expertise. Thus, there seems to be no additional benefit to what is already in place in Scotland.[1212]

Further, some observations made by SERIS with respect to gas liberalization in the UK are also relevant here and support the previous observations made for electricity.[1213]

1209 See also the more detailed discussion of Brunekreeft's social cost benefit analysis *infra* in the context of the actual balancing of the interests concerned.

1210 So-called strategic investment withholding, which has already been explained in Part 1.

1211 In this respect, see the The Brattle Group, n. 191, p. 3.

1212 As regards the changes envisaged for the Scottish ISO arrangements, see The Brattle Group, n. 1194, pp. 72–3. The Brattle Group, 'Regulating unbundled TSOs: rules, incentives or an ISO?', November 2007, on p. 20 also identifies the high concentration of Scottish generation as exacerbating any possible incentives for distortion of investment decisions, which many regard as inherent in the Scottish ISO arrangements.

1213 What follows is a brief summary of SERIS findings, also in response to the UK regulator OFGEM's criticism of its initial findings, which are relevant in the current context thereby expanding on the observations made in Part 1 Chapter 2 on the UK unbundling experience. See in greater detail SERIS, nn. 38, 1048 and 'A Reply to OFGEM's criticism of SERIS's Briefing Paper', Sheffield, June 2006. What SERIS does is not so much to provide a social cost and benefit analysis of the effects of unbundling but rather to assess the working of the UK gas market after what it calls internal unbundling (to include legal unbundling within a corporate group) had been introduced and enforced strictly.

Following these observations, it appears that the widespread claim[1214] that the UK market experience of full ownership unbundling suggests that it significantly changes the behaviour of the energy transport undertaking in that a fully unbundled TSO will focus on optimizing the use of its network, seems not to be true, at least not for the UK gas sector; indicators actually show the contrary.

With respect to the degree of capacity utilization, access arrangements and gas balancing, no relationship between ownership unbundling and 'optimization' could be observed. Improvements occurred could be attributed to other factors such as the mandatory release of gas, the introduction of the Network Code, and regulatory intervention.

As regards suppliers' transportation costs and adequate levels of capital investment, there was some evidence to suggest that these actually deteriorated following the ownership changes.[1215] With respect to gas *infra*structure, there is thus no empirical support from the UK for the Commission's claim that ownership unbundling has or will result in more *infra*structure investment. What is more, the significance of the evidence to the contrary increases if one takes into account that while investment was falling during the 1990s, UK gas demand was rising by almost 25%.[1216]

It can thus be concluded that with respect to full national gas network ownership unbundling, the empirical evidence does not support any assertion that the behaviour of the transport undertaking had significantly changed or that a fully unbundled gas TSO would focus on optimizing the use of its network.

Moreover, it seems that legal unbundling had already sufficed to cure the failure to provide for neutrality between British Gas' trading and transportation interests.[1217]

1214 Which underlies one of the most important motives of the Commission for the introduction of ownership unbundling or a "deep" ISO, i.e. the network investment motive.

1215 The average annual level of investment in the system falls markedly. Further, without the intervention of the UK Health & Safety Executive, the fall in gas *infra*structure investment between 1996 and 2005 would have been considerably greater. See further, SERIS, n. 1213.

1216 SERIS, n. 1048, p. 8.

1217 According to SERIS, n. 1213, during the years 1994–1996, which were the years when British Gas' transportation and supply business were only legally unbundled, there was no significant obstruction to network access and competition in gas supply flourished. British Gas had indeed abused its position to obstruct third party access but these abuses were resolved by internal unbundling and not only after voluntary ownership unbundling of British Gas.

It can thus be established that the eventual success of the UK's gas supply market liberalization[1218] was solely based on legal unbundling. It appears that the indicators used to assess the optimization of the UK gas network, which also included access arrangements, and thus one of the main reasons for the functioning of the UK gas market, turned out to be positive mainly as a result of regulatory intervention. As soon as it became clear that internal unbundling was sufficient to safeguard non-discriminatory access and competition in gas supplies, no further demand for ownership unbundling was voiced.[1219]

Consequently, as a result of serious problems of either underinvestment or at least attempts to 'game' the regulatory system[1220], *improvement* of network optimization in the UK after ownership unbundling has in fact not taken place. There has not been any empirical evidence put forward to show that full ownership unbundling in the UK gas market has resulted in significant changes in the behaviour of the transport undertaking or that a fully unbundled Transportation System Operator will focus on optimizing the use of its network. On the contrary, a gas release programme and the introduction of a Network Code appear to have been more conducive to achieving gas market liberalization.

Although there are significant differences in sector characteristics (non-storability and non-controllability of the flow of electricity as opposed to (limited or full) storability of gas (in gas storages along the pipelines or by way of line-pack in the pipelines) and the controllability of its flow), the apparent lack of investment in the ownership-unbundled UK gas sector should at least prompt an adequate social cost and benefit analysis of any proposed further unbundling measures in Scotland, which must also include a review of ownership unbundling

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1218 As a consequence of massive entry of new gas supply, which was independent from British Gas, onto the competitive sector (at the time only non-domestic customers) of the market at the beginning of 1994, the gas price for industrial customers plummeted, which, inter alia, led the International Energy Agency (IEA) in 1998 to conclude that the introduction of competition into the UK gas supply market "led to changes in the structure of prices, in real pre-tax gas prices in parallel with rising volumes delivered. Consumer choice, including the range of services on offer, has expanded. These trends suggest that gas is being produced, transported and delivered more efficiently and these efficiency improvements are flowing directly to end-users." Reference in SERIS, n. 1213.

1219 SERIS (June 2006), n. 1213, reply, p. 3. No such demand has been made since 1993, well before British Gas decided to break itself up voluntarily. See n. 1048 as regards the attempts of OFGEM and the Competition Commission to enforce ownership unbundling of British Gas between 1992 and 1993.

1220 By overestimating investment requirements prior to the setting of the price control both before and after full ownership unbundling. In this regard, see SERIS (June 2006), n. 1213, referring to corresponding reports by OFGEM and the UK Health & Safety Executive.

of electricity transmission in England and Wales comparable to the review which was carried out for the UK gas sector.[1221]

What should be noted at this stage is that any need for additional regulatory measures to trigger or incentivize investment should be regarded as further undermining the Commission's claims that ownership unbundling would actually lead to less regulation and not more and thus question the suitability of ownership unbundling itself.[1222] At least for the UK, it seems that post-ownership unbundling the demands on the regulatory regime have increased significantly.[1223] This is to some extent not immediately obvious because regulatory costs in the form of, for instance, compliance with rather lengthy and detailed licence documentation, which has necessitated the employment of specialized personnel, have been shifted from the regulator to the industry. This refutes the claim that the cost of regulation of vertically integrated energy supply undertakings were higher than those of regulating the unbundled network undertakings alone.

What should also be borne in mind is that as a result of ownership unbundling, vertical integration or concentration of energy production and supply seems to entail increasingly detrimental effects on energy prices[1224], which foils the primary aim of further unbundling measures, i.e. the introduction of more competition into energy supply for the benefit of consumers. This has been the experience in New Zealand. Vertical concentration of energy production and supply and the increase in energy prices are also highlighted in the Commission's sector inquiry[1225], which confirms the consolidation of the energy markets which also suffer from a lack of new market entry.

For New Zealand, it has been shown that as a result of the far reaching unbundling requirements for electricity transmission and distribution[1226], the development of competition failed and household consumer prices increased, which has lead to a gradual change in policy away from an ownership unbundled energy industry

1221 See SERIS, n. 1213.

1222 SERIS, n. 1213, also observes that the "regulation of private sector capital investment in gas pipeline industries presents some very serious problems of an 'agent/principal' nature which seriously challenge the […] statement […] that, '[f]ull ownership unbundling would reduce the need for increasingly burdensome regulation as the regulatory oversight could be less detailed.'."

1223 An observation which underlines the findings made in this respect in Part 1 Chapter 2.

1224 See in this respect already Thomas, n. 317, and accompanying text.

1225 See Introduction.

1226 New Zealand has forced ownership unbundling of the transmission and distribution networks onto its energy sector.

structure with ex-ante sector regulation being tightened.[1227] This was the result of the fact that after the separation of the retail businesses from the distribution networks, most of these businesses became vertically integrated in the five large generators. Retail competition stopped as soon as vertical integration by generators was consolidated in 2001. This process quickly foreclosed any subsequent retail entry to the market.

Growing vertical integration can also be observed in the UK electricity sector. After separation of generation and retail from transmission and subsequent privatization in 1990, the UK electricity industry experienced a growing tide of electricity generation companies integrating with retail and vice versa.[1228] The UK energy industry has also been experiencing horizontal integration between gas and electricity supply undertakings. With the full opening of the energy supply (retail) market electricity supply undertakings have been moving into the gas retail business and British Gas has been targeting electricity customers. Further, the growing importance of combined cycle gas turbine (CCGT) plants, which accounted for 43% of power generation in Britain in 2002, has intensified the linkages between gas and electricity at generation level.[1229]

What has also to be borne in mind when assessing the suitability of further unbundling measures is that the often cited cross-subsidies from stable network income to the volatile supply business, which are supposed to disturb the so-called level playing field between energy market participants, simply do not take place if there is effective regulation in place, which has never been disputed to be the case in the UK.[1230]

1227 On the New Zealand experience, see only Nillesen, P., Pollitt, M., Sitompoel, R., 'Eigendomssplitsing in Nieuw Zealand', ESB of 20 October 2006, pp. 533–5, and n. 319. See in greater detail also Brunekreeft/Ehlers, n. 38, also as regards the problems involved in rolling back ownership unbundling there. One consequence of the ownership unbundling of the network companies from the commercial electricity supply (generation & retail) businesses in New Zealand was that household customer prices increased, see Brunekreeft/van Damme, n. 38, pp. 21–2, relying on observations made in G Brunekreeft, *Regulation and Competition Policy in the Electricity Market – Economic Analysis and German Experience*, 2003, ch. 10. Another reason why this "experiment" failed was that this structure seems to block the way forward with respect to the promotion of distributed generation to counterbalance the projected decrease in gas availability.

1228 See NERA Economic Consultants, 'Consolidation in the EU Electricity Sector', Report for the Dutch Ministry of Economic Affairs, London, 30 April 2003, p. 155, with detailed examples. See also sceptical in this regard, Thomas, n. 1105, who considers the imperfect working of the UK energy wholesale markets against this background.

1229 See NERA, *ibid.*, p. 156, with detailed examples.

1230 If there is effective regulation, cross-subsidization does not take place and is unlikely to take place in the future. This has been established, at least for the Netherlands, by the Dutch competition authority NMa in May 2007, see n. 156. With respect to the doubtful relevance of cross-subsidies in electricity sector regulation, see Willems/Ehlers, n. 2.

By way of preliminary summary, it can be said that the two measures discussed seem not to have any effect of significance or are even detrimental for achieving those general interest objectives, which are mainly targeted at remedying the claimed deficiencies of vertical integration. Consequently, there is considerable doubt as to whether further unbundling measures in the UK would be suitable for achieving the general interest goals of increased competition and supply security for the benefit of the consumers.

Turning to the issue of proportionality or weighing or balancing the general with the private interest, economic analysis becomes relevant here: More general observations with respect to the benefits of further unbundling of electricity transmission have very recently been made in the first comprehensive social cost and benefit analysis (SCBA)[1231] of ownership unbundling of electricity transmission in Germany, the principal arguments and insights of which are however also applicable to the energy markets of other European Member States and thus also to the UK.[1232] The main results have already been outlined in Part 1 Chapter 2 in the context of the analysis of the proportionality of competition law enforced divestiture of energy networks. In the context given, however, it is worthwhile to go into greater detail:

The SCBA analyses three groups of effects.[1233] First, it analyses the arguments that unbundling increases competition.[1234] To the extent that unbundling triggers more or faster investment in generation capacity, an increase of total available capacity and more intense competition would be the result. If total generation capacity is short, unbundling can have quite substantial price effects, whereas if capacity turns out to be adequate, the effects seem to be small, as one would expect for GB.

Secondly, the SCBA analyses the arguments that unbundling would lead to the building of new interconnector capacity. As explained above the strategic investment withholding argument claims that vertically integrated utilities have insufficient incentives to invest in interconnector capacity in order to hold off

1231 To quantify the step from the status quo in Germany of legal and operational unbundling to ownership unbundling.

1232 See Brunekreeft, n. 9. The following is a very brief summary of this social cost and benefit analysis.

1233 See for detailed discussions on the pro's and con's of ownership unbundling, Brunekreeft, *ibid*.; Baarsma/de Nooij, n. 38; Mulder/Shestalova/Lijesen, n. 37; Pollitt, EPRG 0714, n. 37.

1234 This effect may be direct by intensifying the competition among existing players, or indirect, by facilitating more or faster entry of third parties. More competition can result in lower prices and thereby benefit consumers, and can also increase cost pressure and thereby increase sector productivity.

competition from abroad.[1235] Reversing the argument, unbundling would improve the incentives to build interconnector capacity. It is hard, however, to predict how much new interconnector capacity is needed and to calculate how much of this new capacity can be contributed to unbundling. The effects of new interconnector capacity on competition differ depending on whether they are predominantly used for imports or exports. Further, it should be noted that even if all the incentives to invest are good actual investment may still be impeded by legal obstacles such as delayed building permissions. The SCBA thus suggests that the effect of unbundling on interconnector capacity may actually be very small.

Thirdly, the SCBA analyses how unbundling affects the cost of investment. Additional generation and interconnector capacity in an unbundled environment, notwithstanding the positive effects on competition and trade, will imply higher costs of capital. Also, separating the networks from electricity generation necessarily implies that the coordination of investment decisions of power plants and network is no longer firm-internal.[1236] Instead, external market coordination should take over. This can lead to non-optimal investment. In particular, power plants may be built at the "wrong" location, or, the network may be "oversized", an effect already observed above where the suitability of further unbundling is discussed. A pricing or contractual mechanism will be required, which appropriately signals the investment needs. Such a mechanism, however, requires increased regulation and regulatory oversight.

According to this SCBA, the net weighted effect for society (i.e. the balance of social cost and benefit)[1237] is likely to be positive overall, but small.[1238] Available generation capacity and the effects of unbundling on that capacity make all the difference. If, as is still the case in the UK, adequate generation capacity is assumed, so that investment will not be needed, the positive effects become negligible.

1235 The "stratetic investment withholding" argument has, however, its limitations. Vertically integrated utilities may be long or short in electricity generation compared to electricity supply or retail. Short means that on balance the firm may have an interest to increase interconnector capacity in order to increase the purchase of electricity. Long means that vertically integrated utilities with excess generation capacity (and thus low variable costs) will want to export their electricity, for which they need interconnector capacity. See Brunekreeft, n. 130.

1236 See already *supra* when discussing the suitability of further unbundling measures.

1237 The SCBA calculates the effect on the weighted social welfare (social-cost-benefit). Weighting means that the producers' interests are given slightly less weight to than consumers' interests, which follows the Commission's and national approaches to energy supply sector restructuring for the benefit of consumers. See in this regard already nn. 114 and 305.

1238 Much depends on the relative weight of the interests of consumers and producers (shareholders). With equal weighing the net-effect would be slightly negative.

Thus, it appears that the debate on ownership unbundling is not based on economic facts. From a legal point of view, however, the enforcement of further unbundling measures in GB would appear disproportionate to the encroachment such measures will have on private property rights.

Another important issue to consider when assessing whether a fair balance is struck by further unbundling measures, is the question of the foreseeability of such a legislative measure, or in other words whether further unbundling can be regarded as a normal economic risk, which was to be legitimately expected by the energy supply undertakings affected. In 1989, when the energy supply undertakings were privatized, ownership unbundling and thus the deprivation of their property was not foreseeable for the new private legal owners of the electricity transmission networks because in England and Wales, ownership unbundling was implemented right from the beginning.[1239]

Should one come to agree with the proportionality of further unbundling measures in GB contrary to the conclusions drawn here, then compensation would in principle have to be provided for by law and paid to the vertically integrated energy supply undertakings concerned in Scotland for their (*de facto*) expropriation as a result of further unbundling measures.[1240] Such compensation would have to be paid by the receiving parties because they are benefiting directly from the expropriations, i.e. the transfer of property to them.[1241] The transfer of the networks is to be treated in a similar way to a private transaction – one exception being that because of the general interest, one might come to the conclusion that the full market value should not be reimbursed.[1242] However, because in the current context, domestic courts cannot offer a higher level of protection because they cannot invalidate parliamentary legislation, which is the reason why the ECHR is applied directly here, it can be argued, also against the background that the further unbundling will apply not to the whole industry but only the Scottish undertakings, that they would have to be compensated at no

1239 More generally on this issue, see the ECtHR in re *Fredin*, n. 1152.

1240 As regards the question of who is ultimately responsible for paying compensation, i.e. the Member State implementing an EC Directive or the European Union, see *supra* in this chapter and chapter 7 on the European Union (section II).

1241 It has been established *supra* that a deprivation of property in the form of a formal expropriation does not necessarily have to result in a transfer being made to the State but can also be for the benefit of third parties.

1242 An expropriation without compensation corresponding to the market value can normally be regarded as disproportionate, see Dignam/Allen, n. 1145, p. 270. Even when a "mere" regulation of ownership is at stake, compensation might have to be paid in exceptional circumstances; in this respect, see the discussion reflected in the decision of the BVerfG in re *Denkmalschutz*, n. 551.

less than market value.[1243] They should receive the difference between, on the one hand, the sum received for the transfer of the network property (in the case of ownership unbundling) or of the further competences surrendered (in the case of the enforcement of stricter independent system operation) and, on the other, their theoretic market value (were networks freely tradable).[1244] This is because the market for electricity transmission networks is a buyer's market, i.e. not many buyers are probably willing and capable of buying network assets, so that buyers might be able to dictate the price unless it is determined by an independent and neutral institution.

2. NATIONAL NETWORK OPERATOR TO ENGAGE IN ELECTRICITY GENERATION OR ENERGY SUPPLY?

NGET and NGG are currently prevented by licence condition from being part of a vertically integrated group of energy supply companies which pursues energy production, transportation and supply in the form of retail. As this is part of their licence conditions for competition policy reasons and not explicitly prescribed by law, National Grid Group might want to have these licence conditions reversed in order to obtain a licence to pursue energy production and/or supply.

A claim based on common law, which is not precluded by the HRA 1998[1245], against OFGEM's likely refusal to lift the licence conditions and to grant another licence to another legal entity within National Grid Group, is, however, unlikely to be successful. The setting up and pursuing of an economic activity or trade and the exercise of a profession or occupation of one's own choice are protected by the common law, mainly by the freedom of contract.[1246] However, this freedom is subject to the doctrine of restraint of trade, which is a common law doctrine relating to the enforceability of contractual restrictions on freedom of

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1243 Dignam/Allen, n. 1145, pp. 270–71, infer this from *Lithgow*, n. 1179, no. 122, where the ECtHR distinguishes compensation for whole industries from other cases and requires compensation to be reasonably related to the value of the property taken.

1244 In this respect see also chapter 7 on the European Union.

1245 The Act itself does not provide for protection because, as has been explained *supra*, the ECHR does not include the fundamental freedom of economic activity or freedom to pursue an occupation or business of one's own choice, which would cover any endeavours to take up an activity which has not previously been pursued.

1246 The freedom of contract is the right to choose one's contracting parties and to trade with them on any terms and conditions one sees fit. Negatively understood, freedom of contract is freedom from government interference and from imposed value judgments of fairness. For the notion of freedom of contract, see Sir George Jessel MR in *Printing & Numerical* v *Sampson*, (1875) L.R. 19 Eq. (Law Report Equity Cases) 462, 465.

conduct of business.[1247] The doctrine in its modern form is set out in *Nordenfelt* where it says that "[t]he public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade themselves […] are contrary to public policy, and therefore void. This is the general rule. But there are exceptions: restraint of trade and interference with individual liberty of action may be justified […] if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public […]."[1248]

From this, a two-limb reasonableness test can be deduced according to which the free choice and exercise of economic activity can be restricted where the restriction is reasonable in the interests of the parties and reasonable in the interests of the public. The underlying public purpose of this doctrine is the protection of the individual's right to economic activity, which can only be restrained if the impact of the restraint on the party concerned is fair and if economic development is not inhibited (principles of fairness and economic development).

The licence granted by OFGEM is a regulatory contract between OFGEM and NGET and NGG to which the licence conditions apply. These licence conditions and thus also the conditions in question here are a restraint of NGET's and NGG's and consequently of National Grid Group's freedom of contract and freedom to trade. With the licence conditions, OFGEM regulates the monopolists in GB-wide gas transmission and electricity transmission network operation, and thus the modalities of economic activity and the exercise of an occupation, which includes the prohibition on the National Grid Group pursuing energy supply activities other than energy network operations. This is an objective restriction of the free choice of an occupation.[1249] This restriction must thus be reasonable or fair to

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1247 Instructive in this respect is P Goulding (of Blackstone Chambers), 'All Bets are off – The Future of Garden Leave after William Hill v Tucker', paper delivered to the Industrial Law Society on 14 April 1999. The formation of this doctrine reaches as far back as *Mitchel* v *Reynolds*, (1711) 24 English Reports (E.R.) 347, and *Printing and Numerical* v *Sampson*, *ibid.* The doctrine has played an important part in the development of the common law of employment and is mainly applied to employment cases such as post-termination restrictive covenants and restrictions on competition in contracts for the sale of businesses.

1248 *Nordenfelt* v *Maxim Nordenfelt Guns & Ammunition Co. Ltd.*, (1894) Appeal Cases (A.C.) 535, 565. The right not to be unjustly excluded from the exercise of a trade or profession has been recognised, for example, in *Nagle* v *Feilden*, (1966) 2 Queen's Bench Division Law Reports (Q.B.) 633.

1249 Permission to operate as an energy producer or energy supplier does not depend on any personal conditions a producer or supplier must fulfil but rather on an objective criterion, which is that someone who owns or operates an energy network is not allowed to pursue any other occupation within the energy supply chain.

National Grid, and reasonable from an economic development or public policy perspective.

It does not, however, concern the choice of the subject's initial occupation but is an objective restriction to pursue an additional second economic activity, i.e. a network operator either wants to become active in competitive up- and downstream energy supply activities, or someone active in competitive up- and downstream activities as energy producer or supplier wants to become a network operator. Consequently, such a restriction is easier to justify.

For National Grid being the party of the contract with OFGEM which is subject to the licence condition, it was clear (from the acquisition of Transco which was effected in the course of merging with the Lattice Group) that, as national energy transmission system operator and the owner of substantial parts of the energy transmission networks, it would only be allowed to assume (and retain) such a position if it was to accept these conditions.[1250] Thus, no legitimate expectations could arise, because NGET and NGG were aware that they would not be able to pursue another additional activity within the energy supply chain.

On the other hand, the competitive working of the energy supply markets is in the predominant general interest of market economies, which can provide a justification for preventing threats to the working of competitive markets from arising as can be inferred from, for instance, merger regulation and the special responsibility of dominant market participants towards the maintenance of competition in the market.[1251]

National Grid, which holds the national energy transportation monopolies, could, as dominant player in the market for energy transportation, participate in competition in related markets which depend on the services of National Grid. Albeit this does not *per se* mean that National Grid would abuse its dominant position, in this respect there is at least a potential risk of this happening. As the

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1250 As regards this merger, see already *supra*. In the context of the merger, in 2002, OFGEM modified NGET's (NGC at the time) and NGG's (Transco at the time) licences, see OFGEM, *Regulatory issues arising from the merger of National Grid Group plc and Lattice Group plc to create National Grid Transco plc, Decision document*, September 2002. The modified licence conditions ensured that, inter alia, none of NGC, Transco nor any of their affiliated or related undertakings can be involved in the purchase or sale of electricity, other than with the consent of OFGEM or, as permitted by their respective licences for system balancing purposes. More discussion of these licence conditions can also be found *supra* at n. 1062 and accompanying text.

1251 Once this has happened, however, as is the case with the undertakings at issue here, the special responsibility such a vertically integrated monopoly entails need to be enforced, which does not, however, mean that it is *per se* anticompetitive. In this respect, see also Part 1 Chapter 2.

prevention of vertical integration occurring is a less intrusive form of interference (because the vertical integration has not occurred yet), it can be justified in order to safeguard the functioning of competitive markets for energy supply in GB. From the perspective of economic development and public policy, in particular within an industry of such strategic importance as energy supply, the upholding of such licence conditions by OFGEM as the sector-specific competition authority would be justified.

VI. ARTICLE 56 EC

Should the UK introduce further unbundling measures without being required to do so by a lawful EC Directive (or by lawful parts thereof)[1252], then it might run into conflict with two EC fundamental freedoms, the free movement of capital according to Article 56 EC and the freedom of establishment according to Article 43 *et seq.* EC.[1253] This might be the case because the shares of Scottish Power plc. are wholly owned by the Spanish energy group Iberdrola.[1254]

1252 See also n. 1023. In the case where UK legislation is based on lawful EC Directives or parts thereof (which can be upheld in isolation should some parts, e.g. the prescription of complete ownership unbundling as one option, of a Directive turn out to be unlawful, see in this respect also the text accompanying n. 557), these Directives (or parts thereof) as secondary law are in accordance with primary EC law and thus also with the EC fundamental freedoms, all of which is made applicable in the UK by way of the ECA 1972 and would thus have to be obeyed by the UK. The implementation of the Directives would, however, still have to be checked to ensure they are in accordance with the HRA 1998, see *supra*.

1253 With regard to the question of the relationship between these two EC freedoms, see already n. 571. See also at the end of n. 1254. As has already been said there, in the context under discussion, only the restrictions in the context of the free movement of capital are are subject to analysis here; thus the freedom of establishment will not be further assessed here.

1254 Only legislation which deprives Scottish Power of its property rights is dealt with here. Legislation depriving Scottish and Southern Energy plc. is not dealt with here because its ownership is dispersed and there does not seem to be any controlling share held by non-UK shareholders. From the viewpoint of the EC fundamental freedoms, only cross-border activities are protected, not purely domestic discriminatory activity. See in greater detail and with further references, Ress/Ukrow in Grabitz/Hilf, *Das Recht der Europäischen Union*, Bd. II, Article 56 EGV, no. 39. Should the UK introduce *sector-wide legislation* (as opposed to individual competition law enforcement such as currently enforced in NGET's and NGG's transmission licences, see *supra*) prescribing that (legal) persons holding energy production or supply licences are not allowed to hold energy transmission licences (or *vice versa*) (not even when the holder of the other type of licence is a part of the same group of related or affiliated undertakings), then in theory, questions would arise in the context of fundamental freedoms such as the lawfulness of potential obstacles to the free movement of capital or the freedom of establishment. In practice, however, this does not play a role and is therefore not dealt with here, because GB only has one national energy transmission system operator, National Grid, which is already restricted by the licence conditions of its subsidiaries NGET and NGG. Furthermore, issues relating to non-EU countries, which might arise here or in the context of EC law evaluation, are also not dealt with here. With respect to the applicability of the two

The UK might invoke the improvement of competition in its energy markets in order to achieve energy supply security in the long-term as public security reason according to Article 58(1)(b) EC for depriving the Scottish electricity supply undertakings of their property. Further, the UK might want to achieve greater market transparency in order to enhance consumer protection through greater market transparency and the improvement of the competition in the markets in order to achieve greater environmental protection, such as a more effective emission trading scheme, and easier and non-discriminatory market access of renewable energy sources (RES) and combined heat and power (CHP) in order to fight climate change. It would thus invoke these aims as overriding restrictions in the general interest of Article 56 EC to justify further unbundling.

The legal analysis made in Part 1 Chapter 3 on Article 56 EC with respect to the European Union's competence to introduce further unbundling measures also applies here, with the same results. Further unbundling legislation as discussed in this chapter cannot be considered to be a measure that if proportionate would legitimately restrict the free movement of capital according to Article 56 EC.

If one does not follow what has just been established, then further unbundling measures enforced by the UK must be proportionate, i.e. in order to be justified, they must be suitable for securing the claimed overriding objectives in the general interest and must not go beyond what is necessary in order to attain them. With respect to the proportionality of further unbundling measures, it is referred to the above elaborations on the proportionality of further unbundling measures in the context of assessing their fundamental rights impact.

What needs to be considered additionally in the specific UK context, however, is that the UK still disposes of sufficient generation capacity and possesses a largely vertically separate and effectively regulated energy supply sector, which is particularly true for the energy transmission networks and the separately licensed interconnectors to Norway, Belgium and the Netherlands. Thus, with respect to the issue to energy supply security, it would seem that any further unbundling measure would be disproportionate and thus violate the free movement of capital according to Article 56 EC.

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fundamental freedoms at issue here, the controlling shareholding of Iberdrola in Scottish Power is a direct investment and at the same time the establishment of a subsidiary of Iberdrola in Scotland. Thus, Articles 56 and 43 EC are both in principle applicable. However, what can be inferred from Articles 43(2) and 58(2) EC is that activities relevant in respect of both freedoms are covered by the level of protection as laid out in Article 56 EC, only the scope of the restrictions of the fundamental freedoms are extended in that lawful restrictions of both freedoms are applicable.

VII. CONCLUSIONS

The UK certainly is one of the pioneers in energy supply market liberalization in Europe. Great Britain, which is nowadays characterized by energy supply being entirely in private hands, also possesses one of the most extensively unbundled energy supply markets in the European Union, with further (transmission network) unbundling measures only possible in Scotland. There, two vertically integrated electricity supply undertakings, one of which is in the hands of a Spanish energy supply undertaking, still exist albeit not operating their electricity transmission networks themselves, which is done by a national energy transmission network operator.

The rather advanced state of Great Britain with respect to energy market liberalization was possible for several reasons: in terms of energy supply, the UK was a net gas exporter until recently with (still) sufficient electricity generation in place. The electricity supply market was unbundled before privatization, and the gas supply market has seen the voluntary divestiture by British Gas. Further, the constitutional setting governed by the doctrine of parliamentary sovereignty with the courts playing a subsidiary role (albeit becoming more robust since the coming-into-force of the HRA 1998) certainly contributed significantly to this development. In such a setting, licenses for every stage of the energy supply chain could become highly effective with an almost completely independent and rather powerful sector regulator enforcing the licence conditions ever since privatization. Such individual licences also enforce legal ownership unbundling of the energy transmission networks on the basis of the general competition law powers of the regulator (and not on the basis of sector-specific legislation).

However, not all that glitters is gold: the current state of the market did not come for free; in particular the privatization of British Gas vertically integrated has delayed the liberalization process and the evolution of effective regulation considerably with potentially very high costs for the national economy. *Wright* showed in his analysis of the development of the British gas market that the voluntary divestiture by British Gas can actually not be taken as support for the claim that the European energy supply markets require further unbundling of the energy transmission networks. It actually seems that legal unbundling is sufficient to achieve the competition and internal market as well as the security of supply objectives sought by the European Commission. According to Wright's analysis, the divestiture by British Gas has actually led to deteriorating network investment levels. Also of concern are the neglect of energy supply security for too long as well as the increasing vertical integration of energy wholesale and retail, which threatens to stifle competition in the energy supply market.

The analysis in this chapter has led to the conclusion that further (electricity transmission network) unbundling in Scotland would be disproportionate, in particular against the background that there is still sufficient generation in place, which marginalizes the benefit of further unbundling measures. Such measures would also fail to comply with Article 56 EC.

CHAPTER 6
THE NETHERLANDS

I. INTRODUCTION

This chapter deals with the most significant constitutional issues arising in the Netherlands as a consequence of the recent implementation of energy *distribution* network unbundling within the state organization. However, some discussion will also be necessary as regards electricity transmission networks, which in the Netherlands comprise of lines of 110 kilo Volts (kV) and upwards (see Article 10(1) Elektriciteitswet), which compares to the UK where such lines start above 132 kV and to Germany where they begin above 110 kV.[1255]

As the Dutch energy supply networks are traditionally either owned or controlled[1256] by the Dutch State or its subdivisions (municipalities and provinces), the discussion of network-bound energy supply in the Netherlands (section II) can be kept rather concise compared to Germany where extensive explanation was necessary in order to lay the foundations for the legal analysis of further unbundling measures. Because of the structure of the Dutch energy supply sector, the Netherlands already largely satisfies the demands of the original Commission proposals of 19 September 2007 for third generation Energy Directives.

The Netherlands is a decentralized Unitary State as is the United Kingdom.[1257] Thus, section III will focus on the status of municipalities and provinces in such a unitary system. An exceptional feature of Dutch constitutional law will also be discussed here, and this is the judicial review of Acts of Parliament. The consequence of this feature is that the hotly debated energy *distribution*

1255 See Brunekreeft/Ehlers, n. 38, with further references.

1256 The problem where exactly the ownership of the energy networks lies is discussed in the text *infra*.

1257 In contrast to the UK and Germany, the Netherlands are, however, a monistic constitutional system whereas Germany and the UK are dualistic constitutional systems. See n. 1342 and accompanying text.

network unbundling legislation[1258] will have to comply with the ECHR and EC law.[1259]

This legislation required, *first*, that the operation of all electricity transmission networks from 110 kV upwards transfers by operation of the law to the national, State-owned electricity transmission system operator TenneT with effect from 1 January 2008. *Secondly*, the economic "ownership"[1260] of energy distribution networks must be transferred to the vertically integrated network operation undertakings from 1 July 2008. *Thirdly*, within 2 ½ years from 1 July 2008, i.e. by the end of 2010 at the latest, the operation and the economic "ownership" of energy networks must be transferred to an undertaking outside the current vertically integrated corporate energy supply undertakings whose shares are publicly owned by Dutch municipalities and provinces; such a network undertaking must also be owned directly or indirectly by these public entities.

Thus, section IV will briefly the fundamental rights issues arising in the context of the above legislation. Since the ECHR applies directly in the Netherlands, only such issues will be elaborated upon, which have not already been discussed in the same section of chapter 5 on Great Britain. In this context, it is of particular relevance whether the private corporate holding companies heading the vertically integrated energy supply undertakings[1261], which are wholly owned by Dutch municipalities and provinces, are capable of enjoying fundamental rights protection under the ECHR.

Section V will apply the conclusions of the previous sections to the further unbundling measures introduced in the Netherlands. Section VI will discuss whether the *splitsingswet*[1262] poses obstacles to the free movement of capital

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1258 Consisting of the so-called *splitsingswet*, n. 81, and of the Wet van 1 juli 2004 tot wijziging van de Elektriciteitswet 1998 en de Gaswet ter uitvoering van richtlijn nr. 2003/54/EG, (PbEG L 176), verordening nr. 1228/2003 (PbEG L 176) en richtlijn nr. 2003/55/EG (PbEG L 176), alsmede in verband met de aanscherping van het toezicht op het netbeheer (Wijziging Elektriciteitswet 1998 en Gaswet in verband met implementatie en aanscherping toezicht netbeheer), Stb. 2004, 328, thereafter "I&I-wet". As regards the I&I-wet, J Janssen and L Hancher in (2004/2005) 1 Utilities Law Review 9 already asled 'Energy Regulation in the Netherlands: The Toughest Regime of All?'.

1259 Compliance with the latter when it comes to fundamental freedoms such as the free movement of capital in Article 56 EC.

1260 For the definition of economic "ownership" (*economisch eigendom*), see the text following n. 1297.

1261 The issue of formal organizational privatization (i.e. by establishing private (corporate) law entities (often with a view to substantively privatize them later) as opposed to substantive privatization (where (some or all) assets/shares are sold to privatizing sector investors) will also be discussed in the text accompanying n. 1268.

1262 See n. 1258.

which are not in compliance with Article 56 EC; in this context, the interpretation of Article 295 EC, which has already been discussed in chapter 3, will also have to be taken into account here.

Section VII summarizes the findings of this chapter and concludes.

II. NETWORK-BOUND ENERGY SUPPLY

1. EVOLUTION AND STRUCTURE

Public electricity supply in the Netherlands began at the end of the 19th century based on the objectives that electricity generation should be free of state intervention but nevertheless serve the public interest, that the wholesale market should be run by the Dutch provinces, that supply be pursued by the Dutch municipalities or provinces and that central government approval would be required in special circumstances such as electricity supply by persons other than public institutions.[1263]

As a result, until 1998, the electricity sector was only rudimentarily regulated by an Act of Parliament, and the downstream gas sector, i.e. exclusive of gas production, was not regulated at all until August 2000.[1264] Electricity and gas distribution companies were established in the nineteenth century as municipal

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1263 M Roggenkamp, 'Energy Law in the Netherlands', in M Roggenkamp, C Redgwell *et al.* (eds), *Energy Law in Europe*, OUP, 2nd ed., 2007, no. 11.200.

1264 For electricity, the Electriciteitswet 1989, the predecessor of the E-wet 1998, introduced a system of government control through central government planning and provided for a system of centralized generation of electricity and the planning of generation capacity led by Sep N.V. (*Samenwerkende electricteits-productiebedrijven*) and the setting of electricity tariffs both for wholesale and retail by the Minister of Economic Affairs (except for some special tariffs for large industrial customers), see also n. 1267, and V Aarts, 'The Netherlands', in P Cameron (ed.), *Legal Aspects of EU Energy Regulation*, OUP, 2005, ch. 12.
For gas, until August 2000 only distribution and minimum gas pricing was regulated by the Energy Distribution Act 1997 (revoked in November 2006), which was also valid for electricity distribution and supply, and the Natural Gas Prices Act, respectively. Instead, energy policy notes or papers, so-called *energienotas*, and government policy rules, so-called *beleidsregels* , such as referred to in n. 1269, applied to the (electricity and) gas sector, see Roggenkamp, n. 1263, nos 11.112, 11.132–3. An early policy note of then Minister of Economic Affairs, De Pous, which followed the discovery of the Groningen gas field in 1959, aimed at a close coordination between the production and sale of gas, and established the principle that the public supply of gas is a state task, see in more detail Roggenkamp, n. 1263, no. 11.115. Since 2000, the Dutch gas sector is governed by the G-wet (of 22 June 2000), n. 81, which as the first statutory Act regulating the gas sector led to major changes in the sector and the position of the gas transmission company Gasunie.
The most important amendments to the E-wet and the G-wet, apart from the *splitsingwet*, was the implementation of the 2003 Energy Directives by the I&I-wet, see n. 1258, and the

and provincial companies. In the 1970s, were, upon governmental and parliamentary initiative, these utilities were horizontally integrated by establishing new distribution companies, which supplied gas as well as electricity and heat and at times also water. This restructuring led to changes in the legal form of the distribution companies, which saw the original public law undertaking gradually converted into private law corporate entities (limited companies), in which the municipalities and provinces held all the shares.[1265]

The organization of energy transmission for the gas sector was influenced by the discovery of the Groningen field in 1959 which resulted in the joint marketing of the gas from this field by the Dutch State and NAM, a joint venture company of Shell and ExxonMobile. It was then that the gas transmission undertaking Nederlandse Gasunie NV (thereafter Gasunie) was established, a public private partnership, in which the Dutch State held (directly and indirectly) 50% of the shares and NAM the other 50%.[1266]

By contrast, the electricity transmission company Sep NV was established in 1949 and operated as a public limited company, in which the municipally and provincially owned vertically integrated energy supply companies held all the shares via the then four national electricity generation companies EPON, EPZ, EZH and UNA.[1267]

As can be seen from this brief account of the development of the Dutch electricity and gas supply sector, in particular as regards energy distribution, these sectors

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facilitation of the application of Regulation (EC) 1228/2003, n. 219, and Regulation (EC) 1775/2005, n. 421. On the I&I-wet, see Janssen/Hancher, n. 1258.

1265 Roggenkamp, n. 1263, no. 11.19.

1266 Roggenkamp, n. 1263, no. 11.20. The organization of the gas production sector is rather complicated and for the purposes of this work of lesser relevance. The focus here is on the transmission of gas after landing, its distribution and supply. As regards Gasunie, it was given a key role in the gas supply chain because in addition to the requirement that all gas extracted in the Netherlands had to be sold to Gasunie, it was also responsible for overall Dutch gas supply as well as most gas exports. Consequently, it supplied three classes of consumers: foreign consumers, large industrial consumers in the Netherlands and the Dutch distribution companies. See in more detail, Roggenkamp, n. 1263, nos 11.123 *et seq.*

1267 Roggenkamp, n. 1263, no. 11.20. The national electricity transmission network as a whole was operated (at the time at 220/380 kV) by Sep (as were the interconnectors with Germany and Belgium) although it owned just 65% of the network with the remaining 35% owned by the shareholding electricity generation companies. The energy supply companies operated the regional networks at 110/150 kV and the distribution networks at up to 50 kV. Sep was also responsible for the planning and coordination of electricity generation and its dispatch, and pooled the generation costs. Licensed generators (from 5 MW) had to submit their electricity to Sep, which acted as pool, and then buy it back from Sep in order to supply energy supply undertakings in the area assigned to them. See in more detail, Aarts, n. 1264, nos 12.03–12.06.

have gradually been "privatized" in terms of organization (formal or organizational privatization), which was originally considered to facilitate any later substantive (part) privatization of these energy (distribution) companies by way of transferring them to private investors[1268], which, however, has not and for the energy transmission and distribution networks will also not take place for the time being.

From 1995, it was officially recognized that (substantive) privatization would take place sooner or later after the energy market had been liberalized, which was included in the E-wet and the G-wet as a general objective.[1269] As a result,

1268 Privatization in its original meaning means the transfer of state or communal property rights to private entities. Thus, privatization in a narrow sense only takes place if an undertaking is sold in its entirety and unconditionally (i.e. without contractual means of influence) to private investors, see P Erdmeier, *Die Privatisierung von Unternehmensbeteiligungen des Landes Berlin seit der Wiedervereinigung*, 2000, pp. 20, 21, with further references; see also OECD, *Glossary of Industrial Organisation Economics and Competition Law*, 16 Jluy 1993, no. 161 ('Privatization'), pp. 69, 70, with further references. This classical definition of privatization has been extended significantly during recent privatization discussions. Accordingly, the term privatization is nowadays often also associated with the incorporation of public undertakings in private legal forms, i.e. public undertakings are undertakings the majority of whose capital and/or voting rights are directly or indirectly owned by public bodies or local authorities. In economic theory, the definition of privatization is largely based on the so-called property-rights-theory, according to which privatization means the transfer of rights of disposal, which have so far been in the public sphere, to private entities, leading to the reduction of control by the public sector in financial, legal or factual form, and in its most extreme form, to complete surrender. See Erdmeier, *ibid.* Privatization can in principle be enforced with respect to capital or assets or with respect to tasks; only the former is relevant in the current context. For further discussion of privatization with respect to tasks, see Erdmeier, *ibid.*, pp. 26 *et seq.*, 93 *et seq.* Privatization with respect to capital or assets can take the form of privatization in form only (also known as organizational privatization or *Organisationsprivatisierung*) but only if public rights of disposal are in fact being reduced and private law economic structures are created. The property rights, however, remain in public hands. A formal privatization is thus normally not a final privatization in the sense of a permanent loss of rights of disposal but rather provisional and reversible. Often, such formal privatizations are the first step towards a substantive privatization. Accordingly, the transfer of an undertaking from a public into a private legal form only creates the necessary prerequisite for a sale to private parties. By contrast, in the course of substantive privatizations, rights of disposal of public property are entirely or partly transferred to private entities. Substantive privatizations thus do not only change the extent but also the bearer of rights of disposal. See in this respect also Erdmeier, *ibid.*, p. 25, with further references. Complete substantive privatizations, which transfer public assets to the private sector, correspond to the original narrow meaning of the term privatization.

1269 See, in greater detail, Roggenkamp, n. 1263, nos 11.22 *et seq.* At the time this attitude became official policy the vertically integrated energy supply undertakings had already been operating as private corporate undertakings, i.e. organizationally privatized, so that the recognition that privatization would follow energy market liberalization can only be interpreted as meaning *substantive* privatization. Moreover, for some years now, the Minister of Economic Affairs generally interprets the term privatization as substantive privatization, see the notice (*notitie*) 'Publieke belangen en marktordening', Tweede Kamer, 1999/2000, 27018, nr. 1). What is more, the Dutch government applies this definition in particular to energy sector privatization, see

privatization "only" required the Minister of Economic Affairs' consent to any change in ownership of shares in energy companies which led to the substantive privatization of most of the electricity generation sector.[1270] The energy sector downstream of production and generation, however, was reorganized in that the vertically integrated energy supply companies were required to appoint independent network operators in the form of separate limited companies responsible for the operation of the energy networks.[1271]

This initially positive attitude towards substantive privatization turned into growing scepticism fuelled by the dissatisfying experiences with the liberalization and privatization of national railways in the UK and the Netherlands, which has led to the desire to keep the energy supply networks in state ownership and retain control over their regulated operation. Consequently, the shares in the companies operating the gas and (most of the) electricity transmission networks (Gasunie and TenneT) were acquired by the State after negotiations with the parties involved.[1272]

'Beleidsregels privatisering energiedistributiebedrijven', Stc. 2001, nr. 131 / pag. 8, and the provisions in the E-wet and the G-wet dealing with privatization issues. The ECJ also seems to interpret the term privatization as meaning substantive privatization: as is reflected in the strict neutrality of the EC Treaty towards public and private ownership of economic actors and the 'Golden Share' cases of the ECJ, n. 512, and also the discussion of Article 295 EC in Part 1 Chapter 3 and, with respect to the strict neutrality of the EC Treaty, see chapter 7 on the European Union, in particular n. 1488 and accompanying text), in which the Court seems predominantly interested in the relationship between the size of shareholding in a company and the degree of influence on the company or the rights of disposal resulting from the shareholding. In general terms, it can be said that only if the degree of influence of a (public or private) investor is disproportionately large compared to the size of the shareholding, the mechanisms behind it are scrutinized as regards their potential impediment to the free movement of capital according to Article 56 EC (and the freedom of establishment according to Article 43 EC), in particular whether they are based on a sovereign national measure to establish and preserve this influence. This means, however, that the question of whether an undertaking is public or private is not decided by formal terminology but by economic reality. In this respect, the State is treated like every private investor.

1270 The original Electricity Act 1998 and the Gas Act stipulated in Articles 93(2) E-wet and 85(2) G-wet that any change in ownership of shares in energy companies required the approval of the Minister of Economic Affairs, a provision initially valid until the end of 2002, which from 1 January 2001 has been extended indefinitely. Ministerial approval was granted as regards the sale of the shares of the electricity generation companies UNA, EZH and EPON. The shares were directly or indirectly held through the energy supply companies owned by Dutch municipalities and provinces and were sold to Reliant (now NUON), E.ON and Electrabel, respectively. Currently, 40–50% of Dutch electricity generation is based on CHP.

1271 See Roggenkamp, n. 1263, no. 11.22. On the structure of the Dutch electricity and gas market more generally, J Janssen, L Hancher, M Pigmans, 'The Electricity Market in the Netherlands', (2003) Utilities Law Review 39, and 'The Gas Market in the Netherlands', (2003) Utilities Law Review 85.

1272 See Roggenkamp, n. 1263, no. 11.23. In 2004, Gasunie appointed Gas Transport Services B.V. (GTS) as operator of its gas transmission networks, thereby accomplishing the legal unbundling requirements of Gas Directive 2003. Shortly after, Gasunie was ownership unbundled on 1 July

It was around the turn of the millennium that the privatization debate extended to vertically integrated energy supply companies operating energy distribution networks. Here as well, the Minister's consent to transfer the shares in these companies was required. In 2001, the Minister issued upon the request of Parliament (*Tweede Kamer*) guidelines requiring ministerial approval of any change in ownership of energy networks, network operation companies or of supply licences, which were revoked in September 2002.[1273] During this transitional period, the energy sector in fact saw a substantive (49%) minority privatization of a (relatively minor) gas supply company operating gas distribution networks (Obragas) by sale to RWE, which the Dutch legislator then had to make provision for in the *splitsingswet*[1274]: This minority privatization has, however, been reversed in the meantime because RWE has sold its networks "back" to one of the parties of the original circle of public stakeholders at the end of 2006, which reinforced total public ownership and operation of energy networks in the Netherlands.[1275]

Today, the E-wet and the G-wet contain a prohibition of any substantive privatization of energy supply networks and their operators (even of minority shareholdings).[1276] The networks and their operators now have to remain entirely under the control of the State. The reason for this is that the Parliament (*Tweede Kamer*) did not want to create a situation which could not be reversed; it

2005 with retroactive effect as of 1 January 2005, which split Gasunie up into the autonomous gas transport company Nederlandse Gasunie N.V. and the equally autonomous gas trading and supply company Gasunie Trade & Supply B.V., now GasTerra B.V. on 1 September 2006. The gas transport company Gasunie, of which the State became sole shareholder as of 1 January 2005 buying Shell and ExxonMobile out for a net purchasing price of €2.78 billion, consists of all transport assets of Gasunie, the national transmission system operator GTS and all the relevant contracts belonging to it, including those for carrying out transport services and gas quality conversion. Gasunie also holds a 60% interest in the gas interconnector pipeline between Balgzand in the Netherlands and Bacton in the UK, see also n. 1331 and accompanying text. As regards GasTerra, this remains a private-public partnership in that Shell, ExxonMobile and the Dutch State continue to hold shares. For more detail on the restructuring of Gasunie, see Roggenkamp, n. 1263, nos 11.149 *et seq*.

1273 See the *beleidsregels* mentioned in n. 1269. For the revocation, see Stc. 2002, nr. 174 / pag. 9.

1274 N. 81.

1275 RWE, 'RWE Energy Nederland verkoopt netwerkbedrijven', Persbericht (press release), 23 March 2007.

1276 From August 2003, ministerial approval was forbidden for any transfer of rights to natural or legal persons outside the circle of network owners or shareholders of network operation undertakings. At the time, RWE was still (the only) private shareholder of a network operation undertaking so that the prohibition of privatization could indeed have conflicted with Article 56 EC at *that* time (see more about this problem *infra*). In July 2004, this prohibition became permanent but only as regards networks and their operations.

particularly did not want the energy networks and their operation to pass to foreign investors.[1277]

Disposing of network operators and networks still requires ministerial approval according to Articles 93(2) and 85(2) E-wet and G-wet but is forbidden by law if a transfer to organizations outside the state sphere is envisaged (subsection 3 and 4 of Articles 93 E-wet and 85 G-wet respectively).[1278] Consequently, substantive privatization of energy networks and their operators is no longer an issue unless legislated for by Parliament; the prohibition of substantive privatization could not be more definite.[1279]

On the other hand, municipalities and provinces are (and have even been prior to the entering into force of the corresponding parts of the *splitsingswet* (see below)) allowed without any requirement for approval to sell (parts of) their competitive energy supply activities. However, such substantive privatizations are only possible if any ownership of energy supply networks (see on this issue below) and their operations have been separated from the energy supply undertakings to be

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1277 In the so-called *Memorie van Antwoord* of 29 September 2006, Eerste Kamer, 2006–2007, 30212, D, Eerste Kamer, p. 6, which forms part of the motives of the splitsingswet, the Dutch government declares, translated into English: "[…] The separation of the property ensures that the networks, which are crucial for energy supply, cannot pass into the hands of foreign parties vertically integrated with competitive energy activities. Further, the *splitsing* of the energy undertakings ensures that the network operator is structurally independent and thus guarantees an honest functioning of the market, which the consumer benefits from. Additionally, the *splitsing* of the energy undertakings contributes to the reliability of the energy networks. An important consequence of *splitsing* is that a deadlock over privatization lasting many years has been removed. After all, *splitsing* offers the current public shareholders the opportunity, should they wish to do this, to sell the commercial parts of the energy undertakings." It continues on p. 8: "The separation of the technically orientated network operation and the commercially orientated trading and supply activities means for the management of the network operations that it can focus on reliable and efficient network operations. This reinforced supply security."

1278 Translated into English, subs. 3 of these Articles reads as follows: "Our Minister [i.e. the Minister of Economic Affairs] will refuse the approval required according to subsection 2 if a change in ownership referred to in that subsection of a [gas transport] network results in a natural or legal person obtaining rights with respect to a [gas transport] network, which is outside the circle of the state organization. […]." Subs. 4 reads: "By way of general administrative directives, rules are established with respect to the granting of the approval required by subsection 2 for a change of rights with respect to shares in a network operator. [Such an approval] will not be granted as long as the general administrative directive has not been enacted. The first time such a directive is about to be enacted, this will not happen until a draft has been forwarded to both chambers of Parliament. Within four weeks after forwarding, the wish can be expressed by or in the name of one of the chambers or by at least one fifth of the constitutional number of members of one of the chambers that the content of the draft be established by way of an Act of Parliament. […]."

1279 Recently confirmed by the Dutch court Rechtbank 's Gravenhage, n. 574.

sold in order for such networks to remain within the sphere of the current public owners and shareholders.

2. REGULATION

The central state, the provinces and the municipalities all have regulatory and administrative powers within the state organization outlined in the Constitution. Acts of Parliament may delegate further regulation to both central government and subordinate levels. At central level, delegated legislation can be issued by central government in the form of Orders of Council (*Algemene Maatregelen van Bestuur*), which are enforced by way of Royal Decree (*Koninklijk Besluit*). Delegated legislation can be further delegated to government ministers, which would then issue Ministerial Regulations.[1280] For economic regulation, it is customary that most of the substantial regulation is left to delegated legislation. Accordingly, as the Minister of Economic Affairs is responsible for Dutch energy policy, he or she is thus also responsible for the regulation of the Dutch energy sector. Increasingly, the Minister is issuing policy rules, so-called *beleidsregels*, which render an interpretation of statutory regulations in the energy sector.

In 1998, two new divisions were added to the Ministry of Economic Affairs, the Competition Authority (*Nederlandse Mededingingsautoriteit* or NMa) and the energy sector regulator DTe (*Directie Toezicht Energie*).[1281] Today, the latter, which is responsible for supervising the compliance of both the electricity and the gas sector with the E-wet and the G-wet and for establishing the regulatory framework for the operation of the energy networks and TPA[1282], operates as a branch of the former, which acquired the status of an independent agency in

[1280] At subordinate level, delegated legislation may be issued by provinces and municipalities by way of secondary legislation.

[1281] DTe in fact is a creation of the E-wet, and it was confirmed as regulator for gas in the G-wet as well.

[1282] See Aarts, n. 1264, no. 12.13. The energy transportation tariffs are set according to a form of incentive regulation, see in detail Aarts, n. 1264, Roggenkamp, n. 1263. GTS applies its gas transportation tariff to an entry-exit-system at about 50 entry and 1,100 exit points of its network. At these points, capacity can be bought in order to physically inject gas at a specific point and withdraw it elsewhere from the network system, see further at www.gasunie.nl. The electricity transportation tariff is a postage stamp rate, i.e. it is independent of the distance between the point of connection where electricity is fed into the grid and the take-off point. Consequently, one flat rate per contract gives access to the entire electricity network. Roggenkamp, n. 1263, no. 11.230.

2005.[1283] The Board of NMa issues instructions with respect to the tasks and powers assigned to the Director of DTe under the E-wet and G-wet.[1284]

Framework for energy sector regulation

The regulatory framework of the Dutch energy supply sector has over time developed on an ad hoc basis, and, as has already been said, gradually moved from decentralized regulation to national regulation.[1285] Today, this is reflected in the E-wet and the G-wet, which explicitly stipulate that municipalities and provinces (as subdivisions of the State) are not entitled to regulate energy supply.[1286] It can also be inferred from the requirement of the energy supply undertakings and their shareholders to hold or acquire the *legal* ownership of the energy networks in case of any privatization.[1287] National regulation is largely the result of developments at EC level and the consequent implementation of the Energy Directives. Consequently, it is only since the end of the last millennium that the entire energy sector is regulated by national legislation. And it is only since 1995 that the reorganization, mainly in the form of liberalization, of the Dutch energy supply sector has begun.[1288] The original E-wet implemented the Electricity Directive 96/92/EC in 1998 and the original G-wet the Gas Directive 98/30/EC in 2000.

Unbundling

Under the E-wet 1998, Sep and its shareholders, the generation companies, and the energy supply undertakings also operating networks, were obliged to transfer

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1283 The Management of NMa does, however, act on behalf of the Minister of Economic Affairs as regards exercising its powers under the E-wet and G-wet. The powers comprise, inter alia, appointing the network operators, awarding supply licenses and taking any measures relating to the privatization of energy supply activities. DTe sets the network tariffs and advises the Minister on all aspects concerning the energy market.

1284 On 31 August 2001, the Director-General (directeur-generaal) of the NMa also enacted policy guidelines (*beleidsregels*) demarcating the competencies of NMa from those of DTe under the E-wet and G-wet (Stc. 2001, nr. 168 / pag. 41). Further, both institutions jointly run a monitoring system, the Market Surveillance Committee, and NMa's legal department prepares DTe's decisions on any objections against initial decisions.

1285 Roggenkamp, n. 1263.

1286 Article 83 E-wet, Article 62 G-wet; see also M Roggenkamp, 'De privatisering van energiebedrijven en de eigendom van kabels en leidingen', (2002) NTE 4.

1287 Which follows from the absolute privatization ban according to Article 93 E-wet and Article 85 G-wet. Consequently, it appears that when the so-called cross-border leases end, the municipalities or energy supply companies, which granted these leases to American investors have to acquire legal ownership of the networks subject to these leases, see specifically nn. 1311, 1314 and accompanying text.

1288 See Roggenkamp, n. 1263, no. 11.16.

operation and management of the electricity networks to separate legal entities.[1289] In 2000, the G-wet required legal unbundling only for the operation of gas distribution networks because it was said that energy distribution is better suited for the promotion of competition. As most gas supply companies holding gas distribution networks were horizontally integrated with electricity distribution and supply, the legal unbundling provisions of the G-wet resemble those of the E-wet. The impact of gas distribution unbundling was thus limited as most of the undertakings concerned had already complied with the unbundling provisions of the E-wet.[1290] What is important for understanding the motives behind the introduction of the *splitsingswet* discussed below is that in the course of implementing legal unbundling in the sector, the Minister of Economic Affairs agreed to the establishment of so-called "slim" network operation companies instead of insisting on so-called "fat" network operators.[1291] To become "fat" operators, the vertically integrated energy supply undertaking would have had to transfer the economic "ownership" (explained below) of the networks it either owned or held the economic "ownership" of itself to the integrated network operation undertaking.

1289 See Article 10 E-wet. According to Article 10(2) E-wet, control over the national transmission network and the interconnectors was transferred to TenneT B.V. as a wholly owned subsidiary of Sep. Since the appointment of TenneT as network operator, the ownership of TenneT changed in that three out of four electricity generation companies, i.e. UNA, EZH and EPON (see also n. 1270), were substantially privatized. Since this would have led to the majority of shares in TenneT being held by foreign energy companies, the Dutch State purchased all shares in TenneT from NEA B.V. (the renamed Sep) for €1,157,000 in 2001, see Roggenkamp, n. 1263, no. 11.220. Since then, the E-wet states that the State must hold all shares in TenneT, Article 93a E-wet, now through TenneT Holding B.V., which holds all shares in the network company TenneT TSO B.V. In the meantime, the Dutch State has also purchased all shares in the gas transmission company Gasunie, see n. 1272. TenneT also acquired all shares in TZH, a regional 150 kV network company owned by the generation company EZH, which now is E.ON Benelux. See in more detail, Aarts, n. 1264, no. 12.05.

1290 Roggenkamp, n. 1263, no. 11.144. As a consequence, network operation subsidiaries responsible for operating the gas and electricity distribution networks were established. Whereas the shares in the holding companies of the vertically integrated energy supply undertakings are held by Dutch provinces and municipalities, the holding companies themselves hold the shares in the network operation companies.

1291 Establishing "slim" network operation subsidiaries enables the vertically integrated energy supply undertakings to display the network assets on the balance sheet of the integrated undertaking (normally its holding company), which holds the ownership or economic "ownership" of networks, which is, see in this respect also M Koppenol-Laforce, B de Wit, 'Economisch eigendom en splitsing', (2004) NTE 100, 101. "Fat" means that all financial and operational activities have to be conducted independently from the remainder of the vertically integrated energy supply undertaking so that, for instance, the network operation undertaking would also have sufficient financial resources available to decide independently about the maintenance and investments into the networks they operate. A "fat" network operator would hold the economic "ownership" of the energy networks; they would then be part of its balance sheet.

Because of this development, the Minister of Economic Affairs wanted to install a stronger requirement for independence of integrated network operators. In the context of implementing the 2003 Energy Directives, the E-wet and the G-wet were thus amended and now explicitly require that the integrated network operator holds the economic "ownership" of all networks it operates.[1292] This requirement, however, only entered into force together with the *splitsingswet* discussed below.

This, however, did still not suffice in the eyes of the then Minister of Economic Affairs, Brinkhorst, so that after more than 2 ½ years of extensive debate[1293], the reorganization of the energy sector in the Netherlands culminated, at the end of 2006, in the passing of the so-called *splitsingswet* by both Chambers of Parliament. Without going too much into detail at this point on the reasons why this law was enacted, the objectives of this piece of legislation are, first, to separate the competitive energy supply activities from the network activities for competition and consumer protection reasons and, secondly, to ensure that the networks and their operation will continue to be held and conducted by the current circle of public entities or publicly-owned legal persons for public interest reasons.

Consequently, the *splitsingswet* comes down first of all to ensuring that legal ownership of the energy networks and their operation remains or returns into the hands of the current public shareholders of the energy supply companies or these companies themselves. What is not clear, however, is who exactly owns the energy networks in question (i.e. the electricity and gas distribution networks and the electricity supply networks from 110 kV not yet owned by the national electricity network operator TenneT), the vertically integrated energy supply companies or their public shareholders, Dutch municipalities and provinces.

According to the recent Article 20(2) of the Fifth Book of the Dutch Civil Code (Burgerlijk Wetboek, Boek 5) which was added in 2006, a net, which consists of one or more cables, wires or pipelines, and which is assigned to the transport of solid, liquid or gaseous material, of energy or of information, which is or is going

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1292 With the I&I-wet mentioned in n. 1258. The I&I-wet also introduced the prohibition on using the networks or income therefrom as security in order to attract finance other than such as is attracted for the purpose of the operation and management of the networks themselves, which does, however, not extend to third party security rights existing at the time, Article 93b E-wet, Article VI(12) I&I-wet, such as in the context of cross-border leases, see in greater detail *infra*.

1293 Initiated by the Minister of Economic Affairs, Brinkhorst, with letter (*brief*) of 31 March 2004, 'Liberalisering energiemarkten', Tweede Kamer, 2003–2004, 28982, nr. 18, and letter (*brief*) of 11 October 2004, 'Liberalisering energiemarkten', Tweede Kamer, 2004–2005, 28982, nr. 29.

to be built in, on or above the land of someone else, belongs to the constructor (*aanlegger*) of the net or its legal successor.[1294]

As regards the current energy distribution networks underground, it seems that the energy supply companies do not own them legally.[1295] Only in the case of those parts of the networks which have recently been built do these companies thus have a right *in rem* (*opstalrecht*), and thus can they be certain that they own them legally. For the remainder of these networks, they in fact only possess a right of use[1296], or, as soon as these networks appear in the balance sheets of such companies, the economic "ownership".[1297] Economic "ownership" (as the Dutch term is translated into English) is defined in Article 1(1)(aa) E-wet and Article 1(1)(u) G-wet as "entitlement based on a legal relationship to all rights and competences with respect to a good, with the exception of the right to deliver, and the responsibility for all obligations with respect to that good including the assumption of the full risk of change in value or total loss of the good, without the good having been delivered (to them)." Economic "ownership" thus means more than the mere right to use the energy networks but stops short of conferring the legal ownership title to the network (which, consequently, does not have any great value any more); where such title lies is, as has just been shown, far from clear.[1298]

Because of this uncertainty and in order to achieve the separation of commercial energy supply (electricity generation and energy supply to customers) from the network activities of the vertically integrated energy supply companies, the E-wet and the G-wet prescribe[1299]:

– First, that the national electricity transmission network operator TenneT is the operator of all electricity networks from 110 kV upwards from 1 January

1294 So-called *horizontale natrekking*, which is the exception to the so-called *verticale natrekking* in Article 20(1); as regards the coming-into-being of this provision, see *Memorie van toelichting* of 30 August 2005, Tweede Kamer, 2004–2005, 30212, nr. 3; as regards the analysis of the legal problems before this provision was added to the law, see Roggenkamp, n. 1286.

1295 See Roggenkamp, n. 1286.

1296 *Ibid*.

1297 See in this respect also Koppenol-Laforce/de Wit, n. 1291.

1298 This is the more true since according to Articles 10(3) E-wet, 2(1) G-wet the network operators are appointed by those persons who have the right to use the networks, see Koppenol-Laforce/de Wit, n. 1291. Consequently, the appointment is effected by the economic "owners" of the network, i.e. the vertically integrated energy supply undertakings. The wording of the before named Articles are, however, not entirely clear in this regard when they state that "[d]egene aan wie een […] net *toebehoort*, wijst voor het beheer van dat net […] netbeheerder aan (emphasis added)."

1299 Thereby enforcing the already existing I&I-wet and the *splitsingswet*, n. 1258.

2008 by operation of law.[1300] The vertically integrated energy supply undertakings thus have to surrender the task of operation of these networks, for which they have the right of use (stemming from their economic "ownership" or even full ownership), to TenneT.[1301] As these undertakings remain owners or economic "owners" of the networks in question, they thus receive interest on the capital invested in the assets now operated by TenneT.[1302] According to Article 16(1)(c) E-wet, TenneT has the task of investing in the networks it operates, and according to Article 16(6) E-wet, every network operator holding the right of use of a network operated by TenneT must cooperate with TenneT so that it can pursue its tasks (which includes the responsibility for investment) properly.

– Secondly, that from 1 July 2008[1303], every energy network operator other than the national electricity transmission system operator TenneT[1304] must have the economic "ownership" of the networks it operates, which follows from Article 10a E-wet and Article 3b G-wet. For all electricity networks from 110 kV upwards, which are from 1 July 2008 in the economic "ownership" of the network operators but operated by TenneT, TenneT pays "capital interest".[1305]
– Thirdly, (in Article 10b E-wet) that from 1 July 2008[1306] no legal entity, which is part of the current vertically integrated energy supply holding companies, is allowed to hold any shares in network operation undertakings to be appointed from 1 July 2008 as electricity distribution network operator (and holding from 1 July 2008 the economic "ownership" of the electricity distribution networks).[1307] Similarly, Article 2c G-wet stipulates that from 1 July 2008 no

1300 The phased entry into force of the *splitsingswet* and thus the amendments of the E-wet and the G-wet is governed by the Decree (*Koninklijk Besluit*) of 28 December 2006, (2007) Stb. 13.

1301 This does not hold for the respective networks of Eneco and Continuon-Randmeren (part of Continuon, the network operation company of Nuon), which are subject to cross-border leases, see the decision of NMa of 21 December 2007 (Raad van Bestuur van de Nederlandse Mededingingsautoriteit, Besluit als bedoeld in artikel 41C, eerste Iid van de Elektriciteitswet 1998, Zaaknummer: 102876, 'Overgangsbesluit maximum nettarieven elektriciteit voor aangeslotenen op Hs-netten', Stc. 2007, nr. 249 / pag. 55), in particular nos 13, 14. See also n. 1321.

1302 See TenneT's website at the bottom of www.tennet.org/projecten/OverdrachtBeheer/index.aspx ('Eigendom').

1303 As to the Decree governing the phased entry into force of the *splitsingswet*, see n. 1300. The date of 1 July 2008 applies to network operators already in place at the time of entering into force of the *splitsingswet*.

1304 TenneT already has the economic "ownership" of the parts of the national transmission network legally owned by the Dutch (central) State, see Aarts, n. 1264, no. 12.54 and n. 108 there.

1305 See previous bullet point.

1306 As to the Decree governing the phased entry into force of the *splitsingswet*, see n. 1300.

1307 According to Articles 10(3), 10a(1) E-wet, it seems that the vertically integrated energy supply undertakings can retain the economic "ownership" of the electricity networks from 110kV they still hold, even after the *groepsverbod* takes effect.

legal entity, which is part of the current vertically integrated energy supply holding companies, is allowed to hold any shares in the network operation undertakings to be appointed from 1 July 2008 as gas transport network operator[1308] (and holding from 1 July 2008 the economic "ownership" of the gas transport networks); for both electricity and gas network operation undertakings already appointed on 1 July 2008, *splitsing* must be enforced on 1 January 2011 by the latest. Thus acutal separation (*splitsing* or *groepsverbod*) is achieved by these provisions.

As regards the *groepsverbod*, it should be emphasized that the vertically integrated energy supply undertakings only have to make sure that the operation of the networks ceases to reside within the vertically integrated structure. How this is to be achieved is left to the undertakings to decide.

Another aspect to add in the context of the *groepsverbod* is that originally the splitsingswet passed the *Eerste Kamer* (Upper House of Parliament, which convenes members who are not directly elected) subject to the condition that the provisions dealing with the *groepsverbod* would not enter into force until certain events occur, such as the introduction of similar provisions on the European level or the a finding by the Dutch regulator DTe that the vertically integrated network operation undertaking, which holds the economic "ownership" of the networks it operates, is not in fact not operating them independently. An indicator of such failure to operate independently would be that the vertically integrated energy supply undertaking undertakes investments internationally, which could be interpreted as not using its means to invest sufficiently into networks in the Netherlands.[1309]

At the end of 2006, the Dutch multi-utility Delta, which horizontally integrates vertically integrated electricity and gas supply activities with, inter alia, water supply, waste disposal and the provision of telecommunication, television and internet service, acquired of the Belgian waste disposal company Indaver. In April 2007, this prompted the Minister of Economic Affairs, van der Hoeven (as a member of the Dutch government following the government responsible for the

1308 To be distinguished from the *national* gas transport network operated by GTS.

1309 See Motie van de leden Doek en Sylvester, 14 November 2006, Eerste Kamer, 2006–2007, 30212, H, and Brief (letter) van de Minister van Economische Zaken, de Wijn, of 17 November 2006, Eerste Kamer, 2006–2007, 30212, I, in which he confirmed that the outgoing government would respect these conditions and would request from any succeeding government and Minister of Economic Affairs to also respect the wish of the *Eerste Kamer*. See also Roggenkamp, n. 1263, no. 11.28.

splitsingswet), to establish that an event as described in the previous paragraph had occurred, and to enact the *groepsverbod* (after informing Parliament).[1310]

Municipalities and provinces as the public shareholders of the vertically integrated energy supply undertakings, which have until 1 January 2011 to enforce *splitsing*, can, however, as has already been indicated above, privatize the commercial supply activities in the meantime as long as the retain or obtain the legal ownership of the networks and the network operation activities as outlined above.

Splitsing and cross-border leases (CBL)

One of the most hotly debated issues in the context of the costs and benefits of *splitsing* or the *groepsverbod* are the so-called cross-border leases (CBL). Although they have been heavily used by the vertically integrated energy supply undertakings concerned by the changes of 1 January and 1 July 2008, their exact terms have never been made public for confidentiality reasons.[1311] Consequently, the degree of risk involved has always been subject to uncertainty.[1312]

CBLs have been entered into between 1995 and 2002 in order to take advantage of tax saving opportunities in the U.S.[1313] They are transactions whereby a Dutch energy company grants an American investor a lease of its gas or electricity network for a period of up to 150 years. As consideration, the Dutch company is

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1310 NRC.nl, 'Energiebedrijven moeten splitsen', 03–04–2007; Brief (letter) van de Minister van Economische Zaken, van der Hoeven, of 7 June 2007, Staten-Generaal, 2006–2007, 30212, L en nr. 56, p. 4; Decree (*Koninklijk Besluit*) of 21 July 2007, (2007) Stb. 273.

1311 But see as regards the core elements of the typical CBL used in the current context, the report (*rapport)* of the Commissie Kist of 20 March 2006, Tweede Kamer, 2005–2006, 30212, nr. 17, pp. 28–30. See also NauthaDutilh, 'Client memo leases', Energy & Utilities, 04 November 2005, and Chadbourne & Parke LLP, 'Response to request of the Committee on Economic Affairs of the Second Chamber of the Dutch Parliament to analyze a representative number of U.S./ Dutch cross-border lease transactions', 1 February 2006.

1312 This is why in the current context the provisions made in the *splitsingswet*, n. 81, to avoid any conflicts with CBLs are reviewed here only ih the context of the degree to which they are successful in avoiding such conflict. They are not given too much weight in the discussion of whether the State has acted within its legitimate margin of appreciation nor whether the measures taken sufficiently obey a fair balance between the general and private interests. In the end, only if one comes to the conclusion that compensation is to be paid to the vertically integrated energy supply undertakings involved, the issue of claims arising in the context of CBLs would then become relevant. As a matter of fact, the network operators of Eneco and Nuon (only Continuon Randmeren) have been exempted from the transfer by law of the right to operate its networks of 110 kV and higher to TenneT, see n. 1300 and accompanying text.

1313 The following paragraphs are largely based on M Roggenkamp, 'Ownership Unbundling of Energy Distribution Companies: the Netherlands', (2006) I.E.L.T.R. 240; see also Raad van State, n. 588.

paid a lump sum.[1314] The investor then leases the energy network back to the Dutch company for a definite period of time. As consideration, the Dutch company pays annual rent to the American investor; at the end of the lease, the Dutch company can then (and as a result of the *splitsingswet* would have to) exercise a contractual option and buy the network back for a predetermined price.

The transaction has been construed in such a manner because the Dutch energy company under Dutch law remains legal owner (or economic "owner") of the networks and can thus continue to depreciate them in its accounts.[1315]

The CBLs contain change-of-control clauses, according to which the legal and *beneficial* ownership of the networks and of the shares in the Dutch energy supply undertakings[1316], which are parties to such CBLs, must stay with the public shareholders, i.e. the municipalities and provinces, at least as regards the majority of the shares.[1317]

The *splitsingswet* might conflict with CBLs in three respects:

First, the requirement to transfer economic "ownership" of the networks to the vertically integrated network operator (to make it "fat") might raise a problem for such energy companies as have not transferred economic "ownership" to the

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1314 Which includes a share of the tax savings made by the investor.

1315 See also Koppenol-Laforce/de Wit, n. 1291, and Delta's 2006 accounts (*jaarverslag*), p. 87, available at www.delta.nl. As the term of the lease of the networks from the Dutch company to the American investors exceeds the normal (economic) life of the network, the American investors are also able to depreciate the network as co-owners under American law. Consequently, the American investors pay less tax in the U.S. This construction is nothing more than a loan to the Dutch energy company leaving the economic and financial risk for the network with the Dutch company.

1316 Which, however, must always relate to the actual ownership position the Dutch energy supply undertakings have with respect to "their" networks. If they are an economic "owner" only (according to what has been explained *supra*) and not the legal owner, any requirement to oblige them to be legal owner is naturally impractible. "Beneficial" ownership as phrased in Roggenkamp, n. 1313, can only mean beneficial ownership according to the common law trust law concept, which is likely to have been applied in the cross-border lease agreements with American investors, and then only with respect to the legal ownership of the shares in the Dutch energy supply undertakings. In the context of the energy networks where it is not necessarily clear where the legal title lies, beneficial ownership would either relate to the legal ownership of the networks if known, or, otherwise, to the economic "ownership" of the networks; beneficial ownership of economic "ownership" obviously is a lesser right compared to the beneficial ownership of legal ownership. Additionally, the energy companies also agreed not to transfer their assets to another legal person. All of these are provisions to ensure that no collateral or security, which are the essential bases for the CBL transactions, are withdrawn.

1317 This, again, is another argument for the distinction of organizational from substantial privatization.

operators before 1 July 2008. The transfer of economic "ownership" had, however, already been provided for but not yet enforced in the E-wet 1998 and the G-wet.[1318] Although these provisions found their way into the two Acts at the end of the period in which the conclusion of CBL was still allowed or even shortly after, there has been sufficient time for the parties to the CBLs to inform themselves about the consequences and work out solutions or to make any claims.

More importantly, in particular when it comes to the actual *splitsing*, i.e. separation of the network operator from the energy company which is to come under direct control of the municipalities and provinces (as the public shareholders of the energy companies), the predominant provision all CBLs seem to have in common is that the public shareholders remain in direct or indirect control of the networks and the network operators.[1319] In this respect, it appears that the complete ban on privatization of the networks and their operation should actually be supportive for the operation of CBLs.

The ban and the requirement that economic "ownership" must pass to the network operator can however conflict with CBLs if they provide for the American investors to obtain, upon termination of the lease, the *beneficial* ownership of the grid.[1320] Articles VI-VID of the *splitsingswet* however provide

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1318 The fact that the Dutch government may appoint another network operator should the incumbent operator no longer fulfill its legal duties should not play too great a role here as this is a reasonable and predictable behavior of the State to secure security and reliability of energy supply.

1319 Complications might also arise from the fact that some vertically integrated energy supply companies have not only concluded CBLs on energy networks but also on generation plants. The entering into force of the *groepsverbod* as of 1 July 2008 results in different owners of the networks and generation, which conflicts with CBL provisions that energy companies are not allowed to transfer all or substantially all their assets. This however should not cause too great a headache either because, at least until commercial activities are sold, ownership does only change with respect to direct and indirect control of either the energy networks or generation, both of which, for the time being remain in the sphere of the public shareholders of the energy companies concerned.

1320 Which would only appear to happen should, theoretically, the Dutch party not exercise its contractual option and not buy the network back for the predetermined price. The Dutch legislature was advised, mainly because of the negative tax consequences for the American investors, which could lead to them claiming compensation, not to introduce a provision requiring the Dutch parties to the CBLs to exercise their buy back option, see the advice (advies) of Universiteit Utrecht of 15 May 2006, Tweede Kamer, 2005–2006, 30212, nr. 47. As regards beneficial ownership compared to legal ownership or economic "ownership", see n. 1316. It is submitted that a conflict would be unlikely to arise because the Dutch energy supply companies are not allowed to transfer their rights to the networks elsewhere; it is to be assumed that provision has been made in the CBL agreements in case ownership rights have by law to be moved to subsidiaries.

for these eventualities by way of transitional provisions.[1321] In the context of the mandatory transfer of economic "ownership", Article VI(4) also provides for compensation to be paid in equivalent to its market value. It therefore appears that the only problems, which can arise in this context, are that, on the one hand, additional collaterals or securities have to be provided (which the above Articles also deal with) and tax advantages might be lost.[1322] Compensation payments, on the other hand, do not seem to play too great a role[1323], at least as long as the CBLs can be interpreted on the basis of a salvatory clause, which is usually contained in commercial agreements.

What is more worrying in the context of CBLs however is the fact that legal clarification as to the identity of the persons owning the networks has only recently been provided.[1324] As a result, it is necessary to check whether the energy networks were transferred in the way everybody thinks they were, or whether persons other than the energy companies entering into the CBLs hold some ownership rights, which the parties to the CBLs thought lay with the energy companies. This might then have repercussions with respect to the competence of the energy companies to enter into such agreements and consequently also with respect to the change-of-control clauses of the CBLs. This, however, is less of a problem of the *splitsings* legislation than of the legislature at the time that it clarified the legal situation concerning network ownership.[1325]

1321 Article VIA, for example, deals with the relationship between CBLs and the transfer of the right to operate 110 kV (and higher) networks to TenneT. The decision of NMa of 21 December 2007, n. 1301, concerning the determination and charging of network operation tariffs by TenneT shows how in practice obligations arising from CBLs, to the extent they are known, have been taken into consideration. According to NMa, Eneco and Continuon Randmeren can continue to operate all networks from 110 kV and higher and charge customers connected to such networks themselves whereas for all the other networks of this voltage, whose right to operation was transferred to TenneT by law from 1 January 2008, the charging is also taken over by TenneT. See also TenneT's website at www.tennet.org/projecten/tennext/Overdracht_beheer.aspx.

1322 The latter might be significant, see Baarsma/de Nooij, n. 38, p. 23.

1323 For the consequences, should these nevertheless and unexpectedly become due, see section V(4) *infra*.

1324 See n. 1294 and accompanying text.

1325 The Netherlands Bureau for Economic Policy Analysis (CPB) rendered a qualitative social cost & benefit analysis of the *groepsverbod*, see Mulder/Shestalova/Lijesen, n. 37. It concluded that CBLs may result in one-off costs attributable to the *groepsverbod* but they may not be as a high as expected. The qualitative analysis of CPB has however been severely and substantially questioned by SEO, see Baarsma/de Nooij, n. 38, which carried out a quantitative social cost & benefit analysis. The Dutch government also brought in outside experts to advise on its plans and on the costs involved in the *groepsverbod*: Sequoia, 'Waardering van de Nederlandse Energiedistributiesector', 16 November 2005, analyzed the effects on shareholder value, Deloitte, 'Reorganisatiekosten Splitsing Energiebedrijven', 7 April 2005, looked into the static reorganization costs whereas Roland Berger, 'Reorganisatiekosten van splitsing in dynamisch perspectief', 4 August 2005, looked into the dynamic reorganization costs, Merchant Bank

Interconnector capacity allocation

The E-wet prohibits any priority reservation of capacity on electricity networks and interconnectors.[1326] Since 2001, as regards electricity interconnection, interconnector capacity for imports and exports is auctioned on a daily, monthly and yearly basis by a subsidiary of the TSO TenneT, TSO Auction B.V., which has been commissioned jointly by the Dutch, Belgian and German TSOs to conduct the auctions.[1327] The auctions are governed by the public law Network Code[1328] whereas the legal relationship between TSOs and the bidders is subject to private contract law which is set out in auction rules.

What is important here is that in contrast to most other Member States, the Netherlands has opted for a direct relationship between the power exchange and the allocation mechanism for interconnector capacity. Parties who acquire interconnector capacity at the daily auction run by TSO Auction B.V. for imports into the Netherlands that day must use the capacity acquired for settling electricity spot market transactions at APX in Amsterdam.[1329] Capacity may also be traded between parties[1330] and any capacity that has not been traded or returned to TSO Auction must be used or is lost according to the so-called "use-it-or-lose-it" principle.

Kempen & Co., 'Indicatieve waardeverdeling van Essent en Nuon over de bedrijfsonderdelen', 1 August 2005, and 'Gevolgen van splitsing voor kosten van *Letters of Credit* voor Essent and Nuon', 4 August 2005, studies the value division of Essent and Nuon and the costs for these companies should they have to provide additional letters of credit, EIM, 'Administratieve lasten splitsing energiebedrijven', 10 February 2005, analyzed the administrative costs the *groepsverbod* might involve, and CapGemini, 'Onderzoek naar de werkgelegenheidseffecten van liberalisering, splitsing en privatisering', January 2006, looked into the way liberalization, *splitsing* and privatization affects employment. Finally, a Commission was established, the so-called Commissie Kist, n. 1311, in order to look into the cost effects of the *groepsverbod* and to validate the governments conclusions, including with respect to the CBLs.

1326 The ECJ also ruled in C-17/03 – *Vereinigung voor Energie, Milieu en Water and Others* v *Director of Energy*, (2005) ECR I-4983, that any priority reservation of interconnector capacity to Sep was discriminatory.

1327 Cross-border transmission itself remains in the remit of the TSOs.

1328 DTe has issued this code, which contains special rules for the allocation of cross-border interconnector capacity.

1329 Amsterdam Power Exchange Spot Market B.V. is held by TenneT and Gasunie, see Roggenkamp, n. 1263, no. 11.216. See also Kühling/Hermeier, n. 481, who detect potential conflicts of market coupling in the form of implicit auctioning run by an Auction Office which auctions a combined product of electricity and interconnector capacity with legal unbundling. In the Dutch context, however, these concerns are of lesser relevance as the managers of this form of market coupling, TSO Auction and APX, both belong to the state owned, ownership unbundled network operators, TenneT and Gasunie.

1330 Any party can only hold up to 400 MW in interconnector capacity unless, for instance, an exemption from TPA for new *infra*structure has been granted according to Article 86c E-wet.

New infrastructure

Investment in new *infra*structure is facilitated by Article 22 of Gas Directive 2003 and Article 7 of Regulation 1228/2003 (on cross-border trade of electricity) which provides for a possible exemption from the regular access regime for new *infra*structure in order to attract investment. An exemption can be obtained if (a) the investment enhances competition and security of supply (in related markets), (b) the exemption is not detrimental to the liberalization of the internal energy market, (c) the company responsible for the *infra*structure to be exempted is legally separate from the operator(s) of the network to which the new *infra*structure is connected, (d) if an exemption was not granted the investment would not take place, and (e) the users of the new *infra*structure are charged for their use.

The E-wet and the G-wet in Articles 86c and 18h, respectively, which resemble these provisions, provide the Minister of Economic Affairs with a power to grant an exemption for new *infra*structure from regulated TPA. An exemption can also be granted where a significant increase in existing *infra*structure is to be achieved. When granting an exemption, the Minister may adopt rules for interconnector management and capacity allocation, and may impose time restrictions.

In the gas sector, the so-called Bacton-Balgzand Pipeline (BBL) and several LNG projects are based on this exemption regime.[1331] The construction of BBL and the likelihood of more gas from Russia transported to the UK via the North European Gas Pipeline[1332] and BBL will require the expansion of the Dutch onshore gas networks, for which GTS is under the obligation to take all measures necessary

[1331] BBL is an interconnector between the Netherlands and the UK and a link between the Dutch and the UK gas transmission networks, which are operated by GTS and National Grid Transco, respectively. This interconnector is operated by a company, VOF, which is legally separate from both network operators. VOF was established in July 2004 under Dutch law and is jointly owned by Gasunie BBL B.V. (60%), E.ON Ruhrgas BBL B.V. (20%) and Fluxys BBL B.V. (20%); Russian Gasprom will receive up to 9% from Gasunie's 60% share in BBL in consideration for granting Gasunie a share of up to 9% in the North European Gas Pipeline (NEGP). The shareholders have been selected on the basis of a so-called open season procedure, according to which interested parties can bid for capacity rights in new *infra*structure (see also n. 290). Apart from becoming shareholders, these interested parties also enter into transport agreements with VOF as "their" company operating the interconnector. BBL applied for an exemption under Article 18h G-wet and Article 7ZA (UK) Gas Act 1986 in December 2004, which was granted after amendments were made to the exemption which were required by the European Commission in August 2005. BBL commenced operations in December 2006 and is exempted from regulated TPA for the periods of 10 and 15 years for two different quantities of capacities of physical forward flow from the Netherlands to the UK (thus no exemption for any flows from the UK to the Netherlands), applying the so-called use-it-or-lose-it obligation, see n. 199. See in greater detail, Roggenkamp, n. 1032, pp. 173 *et seq.*

[1332] See also the cooperation between Gasprom and Gasunie, *ibid.*

to ensure the availability of sufficient transport capacity.[1333] GTS used an open season procedure[1334] to assess the extent of expansion needed.[1335]

In the electricity sector, two interconnector investments have taken place.[1336] In May 2008, the NorNed sub-sea interconnector went into operation, connecting the Netherlands to Norway, which is operated on a regulated TPA basis (Dutch tariffs on the Dutch part and Norwegian tariffs on the Norwegian part of the cable).[1337] The other cable is a commercial or merchant interconnector, BritNed, connecting the UK to the Netherlands, for which an exemption from regulated TPA for 25 years was granted by the Dutch and UK regulators on 27 June and 11 July 2007, respectively. BritNed Development Limited is a joint venture of 100% subsidiaries of the UK TSO National Grid plc and TenneT Holding B.V., National Grid International Limited and NLink International B.V., respectively. Customers will have open access to the capacity via a combination of *implicit* auctions (of a combined product of electricity and interconnector capacity) facilitated by APX and short-term *explicit* auctions (of interconnector capacity only).

III. CONSTITUTIONAL SETTING

The decentralized structure of the Netherlands is reflected in its constitution, the *Grondwet*[1338], both in Article 81, which provides for the joint determination of legislation by the Dutch government and the Parliament (*Staten-Generaal*)[1339], and in Part 7 (*hoofdstuk* 7), which deals with provinces, municipalities (communes), water boards and other public bodies. Article 92 *Grondwet* provides for the possibility of transferring by way of a treaty legislative, executive and judicative competences to organizations established according to public international law; this provision is thus the constitutional basis for the Dutch participation in the European Union. When transferring competences to, for

1333 According to Articles 10 G-wet and 16 E-wet the network operators are responsible for the reliability of the energy networks, which means for their maintenance, efficient operation and any investments necessary in order to maintain sufficient spare capacity for the transmission and distribution of electricity and gas.

1334 Explained in n. 1331.

1335 Roggenkamp, n. 1263, no. 11.196.

1336 According to Balmert(Brunekreeft/Gabriel, n. 47, interconnector investment is to be treated as additional generation capacity investment rather than a mere electricity network investment.

1337 In greater detail on the NorNed cable, see van der Lippe/Meijer, n. 44.

1338 Grondwet voor het Koninkrijk der Nederlanden van 24 August 1815 as amended.

1339 Which consists of two Chambers, the *Tweede Kamer*, which is directly elected by the Dutch people, and the *Eerste Kamer*, which consists of representatives of the Dutch provinces, see Articles 50 *et seq*. Grondwet.

instance, the European Union, this can happen contrary to the principles of the *Grondwet* if the law confirming the transferring treaty is approved by the two chambers of Parliament (Article 91(3) *Grondwet*). In contrast to the Federal Republic of Germany with its Article 79(3) GG, there is thus no mechanism, which secures the fundamental principles of the Constitution of the Netherlands. In this context, it is worthwhile to note that Dutch constitutional law and its application is in full compliance with EC law and the ECJ case law[1340], according to which EC law takes precedence or primacy over the Dutch *Grondwet* should the latter not be in accordance with the former: Article 94 *Grondwet* confirms this by stating that within the Kingdom of the Netherlands, legislative provisions, which include the provisions of the *Grondwet*[1341], are not applicable if their application is not compatible with provisions of Treaties and of decisions of organizations established under public international law, which are binding for everybody.[1342]

1. STATUS OF MUNICIPALITIES AND PROVINCES WITHIN THE DECENTRALIZED UNITARY STATE

The Netherlands is a decentralized Unitary State.[1343] Decentralization means the spreading of duties and competences over subordinate public bodies, which are managed by representative organs. Because municipalities and provinces are, as territorial public bodies of general administrative character, part of the framework of the Unitary State, they are subject to administrative supervision. The significant differences between a federation of states or a Federal State and a decentralized Unitary State become clear if one compares the position of a state within a federation or a federal state to the position of a province within a decentralized Unitary State. A state of the former possesses its own sphere of competences and

1340 ECJ, C-106/77, *Simmenthal*, n. 824.

1341 See P Kooijmans, *Internationaal publiekrecht in vogelvlucht*, 2002, ch. 5, p. 86.

1342 The Dutch legal system can be classified as a monistic legal system, in contrast to the German and the British legal system, which are said to be dualistic. The latter means that between the national and the international legal system, there is a strict distinction to be made, which means that international legal norms are only binding within the national legal system if they are incorporated or transformed into the national legal system. A monistic legal system such as the Dutch, by contrast, means that there is no distinction to be made between the national and the international legal system in that international legal norms are automatically part of the national legal system. See in greater detail, Vlemminx/Boekhorst, 'Inleiding Artikelen 90–95: De Internationale Rechtsorde', in Koekkoek, *de* Grondwet, 3rd ed., 2000, p. 444. Concerning the Dutch constitutional discussion whether the Dutch legal system is in fact only to a limited extent to be regarded as monistic, which some infer from Article 93 Grondwet, see Kooijmans, n. 1341, pp. 86, 88, Vlemminx/Boekhorst, *ibid.*, pp. 444–5.

1343 Holterman, 'Inleiding Hoofdstuk 7: Decentralisatie', in Koekkoek, *de* Grondwet, 3rd ed., 2000, p. 557.

powers, which is constitutionally safeguarded; it also has its own *trias politica*, i.e. legislature, government or executive and judiciary, and is also represented on federal level in a chamber of Parliament such as a senate or, as is the case in Germany, in the *Bundesrat*, which usually has significant influence on legislative matters touching upon the federal states' sphere. By contrast, a province within a decentralized Unitary State does not have any of these. The *Eerste Kamer* of the *Staten-Generaal*, the bi-cameral Parliament of the Netherlands, albeit elected by the representatives of the provinces, does not have any federal function; it does not represent the concerns of the provinces.[1344]

The Dutch Grondwet confers some important powers on the Dutch provinces and municipalities, the most notable being the right to set up their own budget. As a result, legislative and administrative functions are exercised on a central, regional and municipal level. Although the provinces and municipalities are relatively autonomous public institutions, they are subject to various types of central control. The Constitution does not clearly define their tasks and responsibilities but only that matters of central government such as defense and foreign affairs fall outside the competence of the decentralized authorities. Matters related to the energy sector such as energy supply are not mentioned in the Constitution. Consequently, the regulation and operation of the energy sector can be dealt with on all three levels of the state organization. This is well reflected in the Dutch energy sector: by the end of the nineteenth century, electricity and gas supply was predominantly regulated by provinces and municipalities. Due to technical developments and the ever growing importance of the energy sector for society, however, the national government has ever since been increasingly involved in regulating the sector via central legislation. As a matter of fact, nowadays the Dutch Parliament exclusively regulates the Dutch energy sector[1345], which shows that the central State can take over any task it pleases.[1346]

The Dutch Grondwet deals with public bodies lower in the state hierarchy than central state institutions in Articles 123 *et seq.* Grondwet. According to Article 123 of the Grondwet, provinces and municipalities can be established or dissolved by a simple Act of Parliament, and the wording of this Article also allows the Parliament to delegate the decision about the determination of the borders of municipalities or provinces.

On the other hand, the Dutch Grondwet contains some safeguards for the independence of existing subordinate public bodies. Tasks, competences,

1344 See, for a good general overview with respect to different state organizations and their comparison, Koekkoek, 'Algemene inleiding', in Koekkoek, de Grondwet, 3rd ed., 2000.

1345 See already *supra*.

1346 As long, obviously as it based on a formal Act of Parliament.

administrative organization and supervision have to be regulated by or on the basis of a formal Act of Parliament. Their ruling bodies[1347] cannot be forced to take on administrative tasks, which public bodies ranking higher in the hierarchy of the administration want to confer on them (so-called *medebewind*[1348] as opposed to autonomous tasks) unless by or on the basis of a formal Act of Parliament.[1349] With respect to municipalities and provinces, the Grondwet contains further safeguards. The most important one has already been mentioned, which is the competence of these territorial public bodies to pass regulations with regard to and manage their own budget (*huishouding*). Other autonomous competences are, for example, public order and health as well as local traffic installations and recreational and cultural installations. On the other hand, these provisions do not hinder higher public bodies from taking over a task or parts of it, which has so far been pursued by a lower public body autonomously.[1350] As a consequence, the autonomous sphere of lower public bodies in the Netherlands has steadily been eroded. Many of the tasks, which have previously been counted towards the budgetary competence of such bodies and thus to their autonomous competences are now exercised in *medebewind*[1351], i.e. as a task, which has been taken over by the central state or a higher public body, and whose management or administration has been conferred back to the lower public bodies.

And lastly, the embeddedness and lack of independent status and own standing[1352] within the state hierarchy and organization of Dutch subordinate public bodies such as municipalities and provinces also shows when one makes

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1347 The mayors (*burgermeester*) and the commissioners of the Queen (*commissarissen van de Koningin*) of the municipalities and the provinces, respectively, who manage the day-to-day business are nominated by the central government.

1348 To some extent comparable to the German communal administrative law concept of *Übertragener Wirkungskreis*.

1349 Article 124(2) Grondwet.

1350 Article 132(1) Grondwet provides for the administrative organization of the provinces and municipalities, and the range and the competences of their government to be regulated by a formal Act of Parliament. Provincial and communal law in the Netherlands includes two repressive types of supervision: in theory, all provincial and municipal resolutions can be revoked or declared void by the central government if they contravene the law or the general interest, see Article 132(4) Grondwet, in practice there are some exceptions for reasons of legal certainty. Further, according to Article 132(5) Grondwet, a formal Act of Parliament can pass any measures necessary if the management or administration of a municipality or province neglects its responsibilities. This stands in contrast to, for instance, Germany where according to Article 37 GG, the *Bundesrat*, the parliamentary representation of the German federal states, the *Länder*, must approve of such measures.

1351 Kraan, 'Het Koninkrijk der Nederlanden', in L Prakke, C Kortmann (eds), *Het staatsrecht van de landen van de Europese Unie*, 5th ed., 1998, pp. 579 *et seq.*

1352 Municipalities and provinces have some limited possibilities of seeking protection against some supervisory measures before the administrative law courts, see Koekkoek in Koekkoek, n. 1344, pp. 33–5.

a direct comparison with German municipalities: whereas in German municipalities can, according to Article 93(1) no. 4(b) GG, complain to the *Bundesverfassungsgericht* claiming that their (institutional) right to self-government according to Article 28 GG has been violated[1353], no such procedural right exists for Dutch municipalities and provinces. There, the central State can only be held responsible for illegal measures with respect to lower public bodies, which, however, is merely an expression of the principle of the legality of public administration.[1354]

2. ACTS OF PARLIAMENT: ECHR AND EC LAW AS STANDARD OF JUDICIAL REVIEW

According to Article 120 of the *Nederlandse Grondwet* the judiciary is not allowed to review formal Acts of Parliament and treaties with respect to their compatibility with the Grondwet.[1355] On the other hand, Article 94 Grondwet stipulates that legislation (which also includes the Grondwet) effective within the Kingdom is not applicable as long as it its application conflicts with a generally binding provision of Treaties or resolutions of organizations established by public international law, such as the ECHR.[1356] Accordingly, the Dutch judiciary can apply public international law to an Act of Parliament and, if necessary, declare such legislation non-applicable if it is in breach of public international law.[1357]

Article 1 ECHR stipulates that the signatories have to guarantee the rights and freedoms of the ECHR to everybody on their respective territories. Further, the case law of the ECtHR is binding according to Articles 32 and 46 ECHR in that

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1353 So-called *Kommunalverfassungsbeschwerde*.

1354 In September 1996, for instance, an Amsterdam court has declared the passing of a regulation which contravenes the law, as being illegal with respect to lower public bodies, in the case in point a municipality. The principle of the legality of public administration would oblige the State to refrain from passing any legislation, which compels illegal actions, see Rechtbank Amsterdam, *Acciardi* v *gemeente Amsterdam*, 11 September 1996, (1996) JB 237.

1355 Any other legal provision ranking below formal Acts of Parliament can, however, be measured against the Grondwet by the judiciary, see Kraan in Prakke/Kortmann, n. 1351, pp. 538 *et seq.*

1356 Kraan in Prakke/Kortmann, n. 1351, pp. 538 *et seq.*; Bax, 'Artikel 120', in Koekkoek, *de* Grondwet, 3rd ed., 2000, pp. 544–8.

1357 According to Kooijmans, n. 1341, pp. 87–88, this also applies to public international customary law, even against the explicit will of the Dutch government. See also Bax in Koekkoek, n. 1356, 545–7, on Dutch case law prohibiting measuring Acts of Parliament against general principles of law, emphasizing the *de facto* abolition of the prohibition on measuring formal Acts of Parliament against the fundamental rights of the Dutch Grondwet by the direct applicability of the ECHR, which according to the monistic legal order of the Netherlands is to be treated as national law, which also applies to the EU Treaty. See extensively M Houten, *Meer Zicht op wetgeving – Rechterlijke toetsing van wetgeving aan de Grondwet en funamentele rechtsbeginselen*, 1997, pp. 241–259.

the national judge always has to construe national law in the light of the ECHR and to determine its compliance with the ECHR. Not only the judiciary but also the executive and legislature are bound to observe this constitutional principle.

The supremacy or primacy of EC law over national law established by the ECJ in its *Costa/Enel* judgment[1358] does not cause any frictions under the monistic legal order of the Netherlands.[1359] Consequently, primary EC law, which includes the fundamental freedoms such as the free movement of capital according to Article 56 EC, and any secondary EC law, which is directly applicable, supersedes Dutch national law, and Dutch national law must be construed in conformity with EC law. Article 6(2) EU, according to which the European Union respects the fundamental rights as guaranteed by the ECHR, also points at the applicability of the ECHR in the Netherlands.

IV. FUNDAMENTAL RIGHTS ISSUES ARISING IN CONTEXT OF FURTHER UNBUNDLING LEGISLATION

As has already been explained, new provisions have been introduced in the E-wet and the G-wet at the end of 2006 with respect to the further unbundling of vertically integrated energy supply undertakings operating energy supply networks in the Netherlands[1360], which are to be scrutinized for whether they comply with the fundamental right to property as set out in Article 1 of the First Protocol of the ECHR.

1. ARTICLE 1 OF 1ST PROTOCOL ECHR

The general discussion in the same section of the previous chapter 5 on Great Britain on the subject-matter of protection and on deprivation as well as on the margin of appreciation[1361] and fair balance also apply here.

1358 ECJ, C-6/64 – *Costa* v. *ENEL*, n. 824.

1359 In contrast to Germany, see there.

1360 See in greater detail, nn. 1300–1309 and accompanying text.

1361 With respect to the ECtHR considering national authorities best equipped to know about the needs of their society in order to establish what is necessary in the general interest, one should think that the Dutch courts are better equipped to scrutinize whether the Dutch legislator pursued *legitimate* objectives of general interest by passing the *splitsingswet*. However, the Dutch judiciary seems to be very reluctant to interfere with the conscious political choice made by the legislative when passing legislation, the examination of which would draw the judiciary unduly into politically contentious issues. Consequently, on the basis of the Dutch

In particular in the context of Article 1 of the First Protocol of the ECHR, which protects the right to property, and the situation in the Netherlands, it needs to be emphasized that historically the ECHR has assumed that nationalization policies are sufficiently in the public or general interest[1362] and thus within the margin of appreciation the ECtHR leaves to the signatory States of the ECHR with respect to the decision as to how to organize their system of property ownership. Accordingly, it can be concluded *e contrario* that the (substantive) privatization of formerly national economic sectors is a sufficient general interest covered by the margin of appreciation of States wishing to legislate in this regard.

2. PUBLIC UNDERTAKINGS AS SUBJECT OF PROTECTION?

Before it can determined whether the provisions of the E-wet and G-wet at issue here are in conflict with Article 1 of the First Protocol to the ECHR, the question of who is protected, or in ECHR terms who is or can be the victim of state interference, requires clarification. In this respect, the discussion in the previous chapter on Great Britain generally also applies here.

The Dutch government, however, claims that the question of protection according to Article 1 can only be posed with regard to the shareholders of vertically integrated energy supply undertakings, and that, consequently, the holding companies of vertically integrated energy supply undertakings are irrelevant as subjects of protection of Article 1 so that such holding companies are not competent to rely on the ECHR. Because the holding companies of vertically integrated energy supply undertakings are owned by public entities, it is claimed that these public undertakings are organizations related to public administration and that for that reason they are to be regarded as governmental organizations according to Article 34 ECHR. Thus, in addition to the discussion in the context of Great Britain, the question of whether such publicly controlled undertakings can be subject to protection is also dealt with here.

Grondwet, the judiciary has so far put great emphasis on the separation of powers when demarcating the competences of the judiciary from the ones of the legislative. See in greater detail, Bax in Koekkoek, n. 1356, pp. 547–8, with further to reference to relevant case law.

1362 Thus justifying an individual's private compensation at less than market value, see Dignam/Allen, n. 1145, p. 270. This historical stance is similar in EC Law, see Part 1 Chapter 3 when assessing Article 295 EC. Dignam, *ibid*., also claims that "[i]n this regard, the ECtHR has reflected the intentions of the framers in the 1950s in promoting socialist policies and doctrines in preference to the economic 'rights' of individuals."

Although there is hardly any case law of the ECtHR, which deals with undertakings with public entities as shareholders, some indications of the Court can be taken as arguments in favour of the ability of such undertakings to invoke the ECHR. In *Agrotexim v Greece* (in detail referred to in section IV(2) of chapter 5 on Great Britain) the Court established that it is not the rule to disregard the legal personality of a company as corporate body, but an exception to the rule; the legal person of the company is thus dealt with separately from its shareholders (which is also the case in the Netherlands, see below). Consequently, if, as is the case with the Dutch energy supply undertakings, which are subject to the amendments to the E-wet and G-wet discussed here, an undertaking possesses the status of a legal person according to national law, it does in principle enjoy the protection of the ECHR.

In the Netherlands, the NV (*naamloze vennootschap*), the legal form in which the holding companies of the vertically integrated energy network operators are incorporated, fulfils the prerequisites of legal personality necessary in the context of the application of the ECHR. Corporate entities or (public or private) limited companies are bodies corporate separate from their incorporating shareholders, i.e. independent institutions with their own organization and competences.

In the Netherlands, this structural separation is further deepened by the so-called *structuurregime* or *structuurregeling*, which applies to public limited (liability) companies of a certain size, which includes large energy supply undertakings such as Nuon and Essent.[1363] Until the end of 2004, one consequence of this regime was that the supervisory board (*Raad van Commissarissen*) was not only largely independent of the general meeting of shareholders but also had a much greater influence on the undertaking's management than in the case of corporate entities not falling under this regime.[1364]

1363 See M Roggenkamp, 'Splitsing energiebedrijven en de gevolgen voor gemeenten en provincies', (2006) Gst. 383, 385–6. The size of company the *structuurregime* applies to is prescribed in the Burgerlijk Wetboek (Dutch Civil Code), Boek 2 (Rechtspersonen (legal persons)), Articles 152 *et seq.* (Titel 4: Naamloze vennootschappen) and Articles 262 *et seq.* (Titel 5: Besloten vennootschappen met beperkte aansprakelijkheid).

1364 The corporate governance of Dutch public limited liability companies (*Naamloze Vennootschappen* or NVs) consists of a two-tier board structure with a management board (*Raad van Bestuur*) in charge of the day-to-day operations of the firm and a supervisory board (*Raad van Commissarissen*). The supervisory board's scope of influence varies substantially depending on which organizational regime the firm adopts. The *structuurregeling* applies to the majority of NVs listed on the Amsterdam Stock Exchange. Until the end of 2004 when the law was changed, two of the main functions of the supervisory board were the appointment and dismissal of the members of the management board, and the approval of, for example, acquisitions and disposals. Until then, members of the supervisory board were appointed by the incumbent members of the supervisory board. In practice, the management board had a very large influence on appointments to the supervisory board. Under the structuurregime as

In July 2004, the *Eerste Kamer* approved a bill revising the *structuurregeling*, which entered into force in autumn 2004. As a result, the shareholders gained greater control, in particular in companies governed by the *structuurregime*. The general meeting of shareholders now has the right to appoint and dismiss the supervisory board. Resolutions of the managing board of an N.V. leading to important changes in the identity or character of the company or business now require the approval of the general meeting. This applies in particular to resolutions transferring most or the entire business of the company, entering or terminating long-term co-operations such as joint ventures, and acquiring or disposing of a company interest with a value of at least one third of the balance sheet total. The rule that the supervisory board appoints and dismisses the managing directors remained unchanged.[1365]

The corporate governance[1366] of a NV includes different bodies with their own competences and the corporate entity's own interest is distinguished from the interest of its shareholders. The distribution of competences depends on what is provided for by the law and the constitution of the company (*statuten*). It can thus be the case that the board of directors can hold competences which are

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it stood at the time the shareholders, apart from exerting informal influence were able to exercise their influence at the annual meeting of shareholders (*Algemene Vergadering van Aandeelhouders*) only on few important issues: they could vote on the financial statement drafted by the supervisory board without amending it and they could nominate supervisory board members but the actual election was made by the incumbent members of the supervisory board. The Dutch annual meeting differed in this respect radically from its German and UK counterparts, where, in principle, shareholders have a powerful effect on the course of events (and on the management) primarily by electing the supervisory board (or board of directors) and voting on important matters brought before shareholders. See in greater detail, R Chirinko, H Garretsen, E Sterken, 'Corporate Control Mechanisms, Voting And Cash Flow Rights, And The Performance Of Dutch Firms', CCSO Working Papers, University of Groningen, January 2003.

1365 See in greater detail, F Buijn, M van Olffen *et al.*, 'Change of 'structure regime' – statutory basis for Corporate Governance Code', Legal Alert, De Brauw Blackstone Westbroek, 7 July 2004. The *structuurregime* is certainly one reason why the Dutch municipalities and the provinces as the public shareholders and thus owners of the energy supply companies concerned have so far not exerted too great an influence on the management of these undertakings. Another reason has already been indicated *supra*, which is that since the beginning of the liberalization process, the provincial and municipal governments have not been allowed (according to Article 83 E-wet 1998 and Article 62 G-wet) to exert any influence on the functioning of the Dutch energy sector by way of secondary legislation, which has ever since then been the responsibility of the Dutch central government. Moreover, the Articles of Association (*statuten*) of the large energy supply companies limit the powers of the shareholders even further as regards the ability to distribute profit and to change the Articles, see Roggenkamp, n. 1363, p. 385. With regard to the distribution of profits, see further *infra* where compensation issues are discussed. The, at times, wide shareholder base (albeit usually with one or two dominant shareholders) has also not been helpful with respect to exerting influence on the energy undertaking's running of its business.

1366 See n. 1364.

usually in the remit of the owners, i.e. the shareholders of the NV, such as the sale of subsidiaries. An example of a conflict between shareholders and their company was the sale by ABN AMRO Holding of its subsidiary, LaSalle:

> "[It has rightly been established] (i) that the determination of the strategy of the company and the undertaking connected thereto in principle is a matter for the management of the company, (ii) that the supervisory board control such matter and (iii) that the general meeting of the shareholders can express its opinion on this matter by exercising its rights conferred upon it by law and the company's constitution. In general, the latter means that the management of a company is accountable for its decision to the general meeting of shareholders but it is, save where the law and the company's constitution provide otherwise, not obliged to ask the general meeting in advance of its decisions if such decisions are made within the scope of the management's competences."[1367]

This means that the board of directors of a company is, under certain circumstances, competent to sell financial participations in the company such as shareholdings. Accordingly, because the management has its own competences, the personality of the shareholders of a company should not be confused with that of the company they own.[1368] Consequently, the holding of a vertically integrated energy network undertaking can in principle be subject of the protection offered by Article 1 of the First Protocol of the ECHR.[1369]

However, the holding of a Dutch vertically integrated energy supply company can only invoke the ECHR if it is not a governmental organization in the sense of Article 34 ECHR. From Article 34, when read in conjunction with Article 1 ECHR, it can be inferred that state institutions and their organs are not allowed to invoke the ECHR. Whether a (legal) person or institution is to be regarded as part of the state sphere can best determined if such person or institution possesses or exercises public authority and/or is embedded in the state organization.[1370]

1367 Hoge Raad (HR), LJN: BA7970, paragraph 4.3, 13 July 2007, (2007) NJ 434 (with comments Maeijer), and (2007) Rechtspraak Ondernemingsrecht (RO) 472 (with comments Wenk); additions and English translation by author.

1368 But see Dignam/Allen, n. 1145, pp. 182, 190–1.

1369 It should be noted though that the Dutch State as sole "shareholder" of the vertically integrated energy supply undertakings operating energy networks (via Dutch municipalities and provinces as subordinate parts of the Dutch State), by amending the E-wet and G-wet (at least with the absolute prohibition on privatizing energy networks and their operation) makes it clear that the management of the formally privatized undertakings may not transfer energy networks and their operation to private parties. The Dutch State thus changes the coordinates for the organization of legal persons, see further n. 1192 and accompanying text, by securing or extending the rights of the shareholders in the energy supply undertakings. To some extent, the Dutch State is therefore expanding the post-2004 *structuurregime*, see n. 1365 and accompanying text, for energy supply undertakings.

1370 Barkhuysen/vanEmmerik, n. 1170, p. 16.

Although the case law seems to be rather fragmented, what is clear is that an organization does not lose its *non*-governmental status if it pursues aims which are also pursued by the State, or when it exercises functions, which the State claims are in the general interest.[1371]

Whereas the supply and distribution of electricity and gas had indeed always been perceived as a state task par excellence, this picture has, however, now changed decisively in that it is now recognized that within certain limits, such tasks can also be exposed to market forces. With the E-wet and the G-wet, the legislator voted for the gradual liberalization of the energy markets. One component of this liberalization process was the (organizational) privatization of energy supply undertakings in order to participate in the competitive process.[1372]

The formal autonomy[1373] of the energy supply undertaking is further reinforced by the fact that each of the vertically integrated Dutch energy supply undertakings, which are subject to the new provisions in the E-wet and G-wet discussed here and thus might be able to claim victim status (i.e. to assert rights) under the ECHR, is held by several public shareholders, i.e. provinces and municipalities which do not necessarily speak with one voice but have divergent budgetary interests.[1374]

As a result of what has just been established, it is indeed difficult to assume that the Dutch energy supply undertakings owning energy networks possess public authority. Consequently, these undertakings are not to be assumed to be

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1371 ECtHR, *Holy Monasteries*, n. 1169. The Dutch State arguably felt responsible for energy supply (although the law has never conferred this responsibility upon the State), and with this goal in mind set up the energy supply undertakings in question here. See also ECtHR, *Ayuntamiento de Mula* v *Spain*, no. 553346/00, ECHR 2001-I, where the Court considers local authorities as governmental organizations because they fulfil public tasks. The Court also refers to international law where "governmental organizations" do not only mean the State itself but also non central authorities.

1372 See nn 1268–1270 and accompanying text where the issue of privatization is discussed.

1373 Which seems to be in the mind of the ECtHR when stating that the "lifting of the corporate veil [happens] only in exceptional circumstances." See n. 1190 and accompanying text. But see also Dignam/Allen, n. 1145, pp. 182, 190–1.

1374 This argument is, however, weakened to some extent because all the shareholders belong to one of the layers of the decentralized unitary Dutch State and thus to the same sphere (much more than, for instance, in the federal state Germany, which affords its municipalities a special institutional guarantee). The European Commission, however, seems in its recent unbundling proposal to consider different layers of state administration independent enough (albeit not distinguishing between different types of state organization) when it calls unbundling and transferring energy transmission networks held by state run energy supply undertakings to a different part of the state organization "ownership" unbundling, see in greater detail, *infra* chapter 7 on the European Union, section II(3).

embedded in the state structure to the extent that would make them governmental organizations in the sense of Article 34 ECHR.[1375] The fact that the energy supply undertakings in question here are held (in private legal form) by decentralized state institutions does not lead to excluding them from claiming victim status according to Article 34 ECHR in order to rely on the protection of their right to property as set out in Article 1 of the First Protocol of the ECHR. Pre-liberalization, it might have been easier to classify such undertakings as governmental organizations. This has, however, changed now that the energy supply sector is (or is in the process of being) liberalized, which is only possible if energy supply is no longer perceived as a task to be exclusively pursued by the State.[1376]

V. APPLICATION TO FURTHER UNBUNDLING MEASURES

Three of the new provisions introduced in the E-wet and G-wet with respect to the further unbundling of vertically integrated energy supply undertakings operating energy networks, require closer scrutiny here[1377]:

The first issue to be examined is the transfer by law of the operation of all electricity networks from 110 kV upwards to the national electricity transmission system operator TenneT from 1 January 2008, which also takes over the task of investing in the networks it operates. The second issue is that from 1 July 2008, every integrated energy network operator other than the national electricity transmission system operator TenneT must have the economic "ownership" of the networks it operates. The third issue is the enforcement of the *groepsverbod* from 1 July 2008, according to which no legal entity which is part of the current vertically integrated energy supply holding companies, is allowed to hold any shares in network operation undertakings, which are appointed as energy distribution network operators from 1 July 2008; for both electricity and gas network operation undertakings already appointed on 1 July 2008, *splitsing* must be enforced on 1 January 2011 by the latest.

The transfer to TenneT and the *groepsverbod* both concern vertically integrated energy undertakings, which possess the right to use energy networks. The question of where exactly the ownership of the energy networks lies (i.e. with the

1375 Which does, however, not mean that they are to be assumed to be substantially privatized.

1376 If at all the State bears a residual responsibility in this respect as a result of which it continues to supervise (certain features of) energy supply by way of regulation. On this issue, see chapter 4 on Germany.

1377 See in greater detail, nn. 1300–1309 and accompanying text.

public bodies or shareholders of the vertically integrated undertakings, the Dutch municipalities and provinces, or with the vertically integrated undertakings themselves) is therefore not relevant here.[1378]

What follows first is the determination, for each of these three issues separately, of the question of whether and if so to what extent they are deprivations of property according to Article 1 of the First Protocol of the ECHR (1–3). This section will then conclude with some discussion of whether the Dutch State has acted within its margin of appreciation when introducing these further unbundling measures and whether a fair balance has been struck between the general interest and the rights of the energy undertakings concerned (4).

1. TRANSFER OF ECONOMIC "OWNERSHIP"

Irrespective of whether the vertically integrated energy supply undertaking, which holds the economic "ownership" of the energy networks to be transferred to the integrated network operation company[1379], is also the legal owner of the networks or not, the economic "ownership" is an economic interest. However, depending on whether legal ownership also lies with the current holder of the economic "ownership" or not, the economic interest is either independently protected or merely a part of the more comprehensive right, i.e. the legal ownership, which then is the subject-matter of protection.

In any event, as regards the forced transfer of economic "ownership", one cannot assume a deprivation of property in the form of expropriation or *de facto* expropriation. This is because the right to dispose of the economic "ownership" is not lost (completely), but has merely converted to a different form, i.e. from immediate possession to intermediate possession (meaning mediated through its position as (sole) shareholder of the integrated network operation company).

Thus, the forced transfer of economic "ownership" is a deprivation of direct use (or non-use)[1380] or control, which means a reorganization of the vertically integrated undertaking's structure or the regulation of an individual competence which forms part of the right to property in the form of legal ownership or economic "ownership" of the energy networks concerned.[1381]

1378 See nn. 1294–1297 and accompanying text.

1379 In order to create so-called "fat" integrated network operation companies, see n. 1291.

1380 The right to property comprises of the positive and the negative right to use, i.e. to do or not to do with one's property whatever one pleases.

1381 Consideration is to be paid according to Article 10a(3) E-wet and Article 3b(3) G-wet in order to compensate for this deprivation in the form of a reorganization of the property rights in the energy networks, and for the "loss" of assets in the balance sheets. This sort of regulation most

2. TRANSFER OF NETWORK OPERATION

The amended E-wet further transfers the right to operate all electricity networks from 110 kV upwards, for which the vertically integrated energy supply undertakings still hold the economic "ownership" (which includes the right to use), to the national electricity network operator TenneT as of 1 January 2008.[1382] These networks are legally owned by those undertakings or their public shareholders; economic "ownership" does not have to be transferred thus leaving the network assets on their balance sheet.[1383]

The right to operate such networks is an economic activity, which is normally protected by Article 1 of the First Protocol of the ECHR. The operation of these networks or, in other words, the ability to control their use is, however, an individual competence which is a part of the right of economic "ownership" or legal ownership of the network property (as the case may be), which, as has just been said, does not have to be transferred.

Thus, looking at the boundary between deprivation of property and the control/regulation of its use, the case at hand is to be classified as the latter[1384], in particular since the vertically integrated energy undertakings concerned receive a capital interest from TenneT[1385] and do not have to bear the responsibility for and thus the risk of investment.[1386]

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resembles the extent of interference admissible under Article 9(2) GG, which is the German constitutional law protection of the fundamental right of association; see further chapter 4 on Germany.

1382 This does not apply to the Dutch vertically integrated energy supply undertakings Eneco and Nuon (with its network operation Continuon Randmeren), which obtained an exemption for those networks encumbered with cross-border leases; both continue to operate and invoice for the use of the respective networks themselves. See also nn. 1301 and 1321 and accompanying text.

1383 See in this respect, n. 1297 and accompanying text.

1384 To give up network operation and leave it to an independent TSO regulates or determines the substance of network ownership because the network owner is not able to make full use of its property (or economic "ownership") any more; it can, however, not be classified as an outright expropriation (full deprivation of property) because the network owner retains its network property or at least the economic "ownership".

1385 See n. 1302 and accompanying text.

1386 The ISO model of TenneT not only confers upon it the competence to operate the electricity transmission networks. TenneT must also assume the financial responsibility for investing into the electricity grids on its own account. This form of independent system operation differs from the European Commission model of independent system operation, which includes the power for the ISO to make investment decisions which the network owner has to implement; see the extensive discussion in chapter 4 on Germany. The Dutch model, however, fulfils the ownership unbundling requirements of the Commission's proposals, which, for vertically integrated energy supply undertakings in public hands, only demand legal unbundling: both, TenneT and the energy supply companies are private legal persons entirely owned by the Dutch

3. *GROEPSVERBOD*

The *groepsverbod* prohibits electricity and gas distribution network operators from being part of a vertically integrated energy supply undertaking pursuing competitive activities such as production, generation, supply or trade of electricity and gas. This means that undertakings in the Netherlands pursuing distribution network operation activities (through legally separate network operation subsidiaries holding the economic "ownership" of the networks they operate) have a choice of giving up either their network operation activities[1387] or the remaining competitive activities by transfer to another legal person outside the current vertically integrated holding structure. Thereafter, the two legal persons pursuing the network and competitive activities, respectively, will either share the same ultimate public shareholders[1388] or, in case the competitive activities are directly sold to private parties, belong to public shareholders and private parties, respectively.

Since the competitive and network operation activities are already being pursued, or, in other words, the freedom to pursue a business or to use or operate the distribution networks are already exercised, it is clear that the *groepsverbod* interferes with the existing economic rights and interests of the energy supply undertakings concerned and that these represent a sufficiently certain economic value.

The competitive activities are legally owned by the vertically integrated energy supply undertakings. As regards the distribution network activities, these are either in their economic "ownership" only (without being legal owners), which allocates them a legal (and not only financial) sphere (and rights) independent of the actual legal owners, or these undertakings are indeed the legal owners.

State and its subdivisions, the municipalities and the provinces. The consequence of the Dutch ISO model is that no tension can arise between the competence to operate the networks and the financial risk because there is no separation between the investment decision maker and the bearer of the risk held responsible or financially liable if the investment proves to be a commercially flawed decision. This is also alleviated by the fact that TenneT does possess major assets because it operates the state-owned grids under its economic "ownership", see TenneT's 2003 accounts (*jaarverslag*).

1387 By either closing their network operation companies down and appointing a new network operator thereby selling the economic "ownership" of such companies or by selling the entire network operation business.

1388 Which as shareholders of the holding company belong(ed), strictly speaking, to the group structure of the vertically integrated energy supply undertaking so that the energy networks and their operation, albeit leaving the holding structure, "merely" shift within the group structure.

By requiring the surrender of the commercial activities, the *groepsverbod* would result in a deprivation of property in the form of a straightforward expropriation of commercial property *and* of an economic activity.

Surrendering the economic "ownership" (without having the legal ownership) of the networks would mean a deprivation of property in the form of an economic interest independent of the "main" right (i.e. the legal ownership of the networks), *and* an economic activity, i.e. the operation of the energy distribution networks.

Surrendering the economic "ownership" (as legal owner) of the networks, the *groepsverbod* would lead to a deprivation of property in the form of a *de facto* expropriation of network property because it leaves the legal right or title to the network ownership as an "empty shell" (with the formal right to sell the property as a mere relic) without any value, which becomes even more apparent if one considers that the legal owner is not competent to appoint the network operator[1389] and that the prohibition of substantive privatization[1390] additionally extremely limits the range of potential purchasers and thus the purchase price to be achieved very likely to stay far below market value.[1391] The *groepsverbod* would here also lead to a deprivation of property in the form of a straight-forward expropriation of an economic activity, i.e. the operation of the energy distribution networks.

It is questionable though whether the *groepsverbod* can be interpreted as a deprivation of property at all in the sense of a forced transfer of ownership in a legal sense because the *groepsverbod* does not demand the surrender of a specific property thus leading to a specific deprivation, but leaves some leeway (as just described) for its enforcement. The only thing the *groepsverbod* makes clear is what is not allowed to happen, which is that the network operator remains part of a group of companies containing other corporate legal persons which generate

1389 See n. 1298 and accompanying text.

1390 See nn. 1276, 1279 and accompanying text.

1391 *De facto* expropriation is likely to be successful here, against the trend, see Müller-Michaels, n. 535, pp. 75–6, because no sensible alternative way of using the network property would be left to the vertically integrated energy supply undertakings legally owning the networks; the only sensible use of the networks is and can be made by the economic "owners" of the networks. It is the economic "ownership" or use of the networks (which is the subject matter of the depriavation) which is the only basis for the determination of the value of the network property. Nor is the preservation of the property value as alternative use applicable here because the value of the network property shifts to the economic "owner", and the legal title in itself is worthless. At the time that the energy supply undertakings were formally privatized, see n. 1268 and accompanying text, and/or became legal and/or economic owner of the energy networks, the *groepsverbod* and thus the deprivation was not foreseeable either, a factor to be taken into consideration when assessing whether a de facto expropriation has taken place, see Müller-Michaels, *ibid*. See also nn. 559, 1161.

electricity, produce gas or supply energy.[1392] This means that there is no forced transfer of property of any kind to the State, the originator of the expropriating legislation (except for the fact that network ownership and operation must stay within the state sphere (prohibition of substantive privatization); State sphere means the members of the current circle of state entities holding shares in the energy supply undertakings with integrated network operation companies).[1393] This is so because the *groepsverbod* can equally well be fulfilled by selling the commercial activities to private parties directly (thus leading to a substantive privatization in this respect).

However, the sale or transfer of property to private parties is indeed to be regarded as deprivation of property under the ECHR despite the fact that it is not a forced transfer of property to the State. This is because the transfer is imposed by a state measure and not based on free will; the fact that there is a choice between alternatives is not relevant because ultimately, one or the other property must be surrendered, both the alternative choices leading to a deprivation of property.

This view is supported by the ECtHR according to which it seems to suffice that the State has ordered the sale in order to invoke Article 1 of the First Protocol of the ECHR in a case like this. This can be inferred from *Kanala*[1394] where the Court establishes that an execution ordered by a judge cannot be regarded as an expropriation by the State but nevertheless leads to a deprivation of the applicant's property.[1395]

To sum up, the *groepsverbod* is to be classified as deprivation of property (expropriation or *de facto* expropriation) rather than a deprivation of the right to use, control, let or sell (regulation of ownership). The property protected here is either

- the commercial property and economic activity or
- the independent economic interest (stand-alone economic "ownership") and the economic activity or
- the legal ownership of the networks (by way of *de facto* expropriation).

1392 What the *groepsverbod* in essence requires is that not only do the current vertically integrated energy undertakings have to dispose of "their" economic "ownership" but also that the legal owner is likely to have to approve of the disposal according to the new *structuurregime* in place since the end of 2004, see n. 1365 and accompanying text. Consequently, should a vertically integrated energy undertaking not be the legal owner of "its" energy networks, then the public shareholder(s) who is (are) the legal owner(s) of the energy networks would also have to participate in the disposal of the economic "ownership" of the energy networks.

1393 As defined in the Regeling (Regulation) eigendom energienetten van de Minister van Economische Zaken van 25 januari 2008, nr. WJZ 8008859, Stc. 2008, nr. 42 / pag. 9.

1394 ECtHR, *Kanala*, n. 1196.

1395 See n. 1197 as regards the German terminology in this respect.

In all three cases, a deprivation of property also takes place with respect to a straightforward expropriation of an economic activity, either as regards the deprivation of commercial activities or the deprivation of the operation of the distribution networks.[1396]

Further, the economic "ownership" of the energy distribution networks must be carved out of the current holding structure and must remain within the current circle of the public shareholders, which is in effect a prohibition of substantive privatization of the energy distribution networks and their operation. On the other hand, the commercial activities can be sold directly to private parties thus permitting substantive privatizations in this regard.

As the property transfer is enforced by a state measure, i.e. by the relevant legislation, and has thus been ordered by the State, the State can be held responsible for the deprivation of property, one way or the other. In principle, the Dutch State would therefore have to make provision (in or by law) for just compensation, a question however, which is discussed below.

4. MARGIN OF APPRECIATION AND FAIR BALANCE

All three legislative measures discussed before have to pass the fair balance test which the ECtHR applies in all cases of interference with the rights conferred by Article 1 of the First Protocol of the ECHR, no matter which sort of deprivation is at stake. What needs to be borne in mind though is that the fair balance test rarely results in a state intervention being declared illegal.[1397] This normally only happens in cases where the State has evidently overstepped its margin of appreciation with respect to whether a general interest justifies the measure constituting the state interference, or in other words if the motives of the state for pursuing certain measures are manifestly unreasonable. The ECtHR considers this margin to be rather wide as long as the state measure complained about is in the general interest, which local governments are supposed to know best[1398], a

1396 As already mentioned *supra*, Article 1 of the First Protocol is extensively interpreted by the ECtHR whereas in Germany, the protection of the right to property according to Article 14 GG is unlikely to cover the economic activity as well, see n. 1198.

1397 See chapter 5 section IV(1)(c).

1398 The ECHR does not distinguish between various types of general interest, i.e. whether they are of economic or non-economic nature, which may play some role in the justification of impediment of EC fundamental freedoms such as Article 56, see R Streinz, *Europarecht*, 8rd ed., 2008, no. 833. But even if such a distinction were to be made, the functioning of the (internal) market and undistorted competition (albeit on the face of it economic general interests) serve the functioning of the economy and thus society as a whole so that they also are

principle of deference to national government which is followed by the Dutch judiciary. They thus test these objectives rather cautiously.

The degree of reasonableness of the general interest justification becomes relevant when weighed against the private interests of the complainant in order to find out whether a fair balance has been struck between the general interest and the private interest, or, in other words, whether the measures taken are proportionate to the aims pursued. Where the fair balance or proportionality test (which is part of the assessment of the margin of appreciation and the question of lawfulness which turns on matters such as the predictability of state measures) shows, however, that there are less intrusive means available to achieve the general interest objectives, this usually only influences the amount of compensation to be paid (instead of the state measure being struck out as disproportionate).[1399]

Thus, the measures discussed here will only briefly be assessed as to whether they are appropriate and necessary to achieve the general interest objectives of the Dutch legislator. Of greater if not predominant significance in the particular Dutch scenario is the issue of the compensation the energy companies receive for their breaking-up.

The case of the Netherlands is particular because here a rather paradoxical situation arises. On the one hand, it can be argued that the energy companies concerned are victims according to the ECHR and can thus rely on fundamental rights protection, on the other hand, any compensation payable is only on the face of it a remedy for these companies as they will not benefit from it in substance.

Margin of appreciation

Starting with the margin of appreciation, there is no cause for doubt that in principle the general interest for introducing further unbundling legislation includes legitimate aims. The government sets out their objectives as follows[1400]:

- definitive independence and integrity of the Dutch energy network;
- guaranteed level playing field for all energy suppliers active in the Netherlands for the benefit of consumers; and
- reducing the burden imposed by the supervision and regulation of the energy sector.

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to be seen as non-economic general interest, which are, in any event, imperative reasons of general interest.

1399 See in greater detail, chapter 5 section IV(1)(c).

1400 Letter of 7 June 2007, n. 1310, summarizes the objectives of the *splitsingswet*.

These further broad objectives were detailed in previous official documents[1401]:

- creating transparency in energy markets: the Dutch government claims that vertical integration can lead to cross-subsidies, exchange of information, and favoured treatment (both financial and non-financial) of the integrated supply business, which harms transparency and the level playing field;
- guaranteeing security and reliability of supply and thus public order and security by ensuring that the operation of the energy networks is pursued independently and under public control; and
- protecting network customers and consumers: customers are supposed to benefit from the *groepsverbod* by way of more transparency, greater choice and the expected introduction of new and innovative services.[1402]

1401 See, for instance, the original motives or legislative memorandum (*memorie van toelichting*), n. 1294, p. 43, and the further elaboration on the motives of legislation in the *nadere memorie van antwoord* of 31 October 2006, Eerste Kamer, 2006–2007, 30212, F, pp. 32–3.

1402 These objectives find some support in the motives of the current EC Energy Directives and the proposals of the European Commission of 19 September 2007 to revise the current energy legislation; in the context of the latter, the Commission in its *Explanatory Memorandum* of 19 September 2007, n. 15, refers to the experience (doubtful and in parts rebutting the conclusions drawn from this experience, Pielow, n. 11) with integrated TSOs where it claims that three problems would arise: *First*, the TSO might treat its affiliated companies better than competing third parties by using its network assets to make entry more difficult for competitors. For this claim, the Commission refers to economic theory, according to which legal and functional unbundling did not solve the fundamental conflict of interest within integrated companies, whereby the supply and production interests aim to maximise their sales and market share while the network operator is obliged to offer non-discriminatory access to competitors. This inherent conflict of interest would make it almost impossible to control the problem by regulatory means as the independence of the transmission system operator within an integrated company would be impossible to monitor without an excessively burdensome and intrusive regulation. *Secondly*, the Commission claims that under the current unbundling rules, non-discriminatory access to information could not be guaranteed as there would be no effective means of preventing transmission system operators releasing market sensitive information to the generation or supply branch of the integrated company. *Thirdly*, the Commission claims that investment incentives within an integrated company were distorted. Vertically integrated network operators had no incentive for developing the network in the overall interests of the market and hence for facilitating new entry at generation or supply levels; on the contrary, it claims, they had an inherent interest in limiting new investment when this investment would benefit its competitors and bring new competition onto the incumbent's "home market". Instead, the investment decisions made by vertically integrated companies tended to be biased to the needs of supply affiliates. Such companies would seem particularly disinclined to increase interconnection or gas import capacity and thereby boost competition in the incumbent's home market to the detriment of the internal market. *In conclusion*, the Commission contends that a company that remains vertically integrated has an in-built incentive both to under-invest in new networks (fearing that such investments would help competitors to thrive in "its" home market) and to privilege its own sales companies when it comes to network access. This would damage the EU's competitiveness and its security of supply and prejudice the attainment of its climate change and environmental objectives." See already Part 1 Chapters 1 and 2.

The *Raad van State*[1403] as the institution of the Dutch government which provides independent advice did not find any cause to question these reasons of general interest put forward by the Dutch government[1404]:

> "In the motives (*Memorie van Toelichting*), it is outlined that the legislation on the unbundling of the energy supply undertakings [*splitsingswet*] aims at safeguarding the structural independence of the network operators and related thereto the transparency on the energy market. The *Raad* is of the opinion that these are general interests, which can justify the unbundling. In this context, it refers to the jurisprudence of the ECJ where such aims albeit not yet explicitly recognized as legitimate imperative reasons [imperative reasons of general interest or rule of reason-exceptions in the context of Article 56 EC] can be inferred from. The ECJ has decided in its *Golden Share* cases that ensuring the stocking of energy (for the reason of security of supply) can be regarded as a reason of public security, which can justify an impediment of the free movement [of capital]. Other aims of general interest, which the Treaty and the ECJ recognize as legitimate imperative reasons are the public order and the protection of consumers."[1405]

In addition to what have been put forward as general interest reasons for the introduction of further unbundling measures, the absolute prohibition of privatization of energy networks and their operation also appears to be a legitimate aim of the Dutch legislator; it aims at retaining the network part of the energy sector entirely in national ownership, an aim which was accepted as

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1403 The Raad van State is the most important advice institution of the Dutch government. Its tasks are set out in Articles 73–75 of the Dutch Grondwet. One of these tasks is the giving of advice on legislative bills, which are checked with respect to their quality and enforceability, and their compatibility with the *Grondwet* and other laws and treaties. The Raad must always be involved before a bill goes to Parliament. It either approves of it (1), does not have any (grave) concerns and recommends amendments to the motives or bill itself (2 & 3), does have objections to one or more parts of the bill, which can in most cases be rectified (an advice which was given in the case of the *splitsingswet*) (4), or it does have gave objections, which are difficult or impossible to rectify and recommends not sending it to Parliament (5 & 6). In the case of the last three outcomes of an advice, the bill must be submitted to the Ministry of Justice and approved by the cabinet of Ministers before it can be sent to Parliament. The advice of the Raad van State is of great importance for the subsequent debate in Parliament.

1404 See the advice of the Raad van State, n. 588, p. 10 (translation by the author), in the context of assessing any unjustified interferences with Article 56 EC. According to the author, the evaluation of the general objections is valid; the author does not, however, consider Article 56 EC applicable in the context of the further unbundling legislation discussed here now that it has ultimately been decided to prohibit any privatization, see further *infra*. The Raad van State gave its advice at a time when partial privatization (in the form of a minority stake for private investors) was still considered an option.

1405 Additions by the author. With respect to the general interest objectives given by the Minister of Economic Affairs, the Raad van State in its recommendations only expands on them and on the further reasons named by the Raad van State in the motives of the *splitsingswet* bill but other than that did not have any concerns about or objections to the objectives pursued by the Minister.

falling outside the remit of the ECHR when the Convention was first established.[1406]

Further, these additional unbundling measures do not go beyond the Dutch legislator's margin of appreciation just because they exceed current and proposed European unbundling requirements as set out in the 2003 and proposed Energy Directives.[1407] In this respect, there is not much to add to the following statements of the Dutch government on 31 October 2006[1408]:

> "From the case law [of the ECJ] it can […] be inferred that in as far as a Member State wishes to introduce a measure which exceeds a European Directive, and where no complete harmonization exists as yet, the compatibility of such a measure must be checked against the general principles of the EC Treaty as interpreted by case law [reference is made to ECJ, 14 December 2004, C-309/02, *Radlberger*, nos 52–83]. Only if the measure to be introduced impedes the effective working of the applicable Directive or contains a deviation from what the Directive intends to harmonize is there a special obligation to justify the introduction of the measure. [Articles 95(4) and (5) EC are not applicable] just because […] a national measure is concerned which exceeds a community minimum harmonization. Article 95(4) and (5) EC are instead targeted at a situation where a Member State wishes to establish a national provision which deviates from a community harmonization measure, for instance, in the area of environmental protection. […]."[1409]

The measures at issue here do not contravene the harmonization efforts of the current or proposed Energy Directives just because they exceed the minimum harmonization efforts of the current European legislation and deal with energy distribution network unbundling, whereas the tabled proposals are only concerned with energy *transmission* network unbundling.[1410]

1406 See n. 1362 and accompanying text with respect to nationalizations and, *a contrario*, privatizations in the context of the ECHR. See also, in the context of the European Union and by way of comparison, the interpretation of Article 295 EC, Part 1 Chapter 3 *supra*; in the EU once substantive privatizations have taken place, the EC Treaty provisions are fully applicable.

1407 The 2003 Energy Directives explicitly provide for the possibility of further unbundling measures, see Articles 10(1), 15(1) Electricity Directive 2003, Articles 9(1), 13(1) Gas Directive 2003.

1408 See the *nadere memorie van antwoord*, n. 1401, p. 32.

1409 Additions and translations by the author.

1410 With respect to the reasons as to why no further unbundling measures have been taken *as yet* as regards the energy *distribution* networks, see Recitals 16 and 15 of the Commission's proposals for Gas and Electricity Directives of 19 September 2007, n. 15.

Predictability of the groepsverbod

The *groepsverbod* was included by the *spiltsingswet* in the E-wet and the G-wet and has thus become part of the legislation in a formal sense. The enforcement of the *groepsverbod* was initially delayed until certain conditions are satisfied.[1411] In this context, it was left to the Dutch government and the Minister responsible to determine the satisfaction of such conditions and consequently to enforce the *groepsverbod*.

As already stated above, the lawfulness or legality of state actions is normally not the decisive factor with respect to whether a fundamental right has been breached or not. Legal certainty and the predictability of legal provisions can however play a role when it comes to the appreciation of whether a fair balance has been struck between the general and private interests. The question here is whether the enforcement of the *groepsverbod* on 1 July 2008 was predictable for the vertically integrated energy supply undertaking concerned.[1412]

The request (*motie*) by Members of the *Eerste Kamer* that the outgoing Minister of Economic Affairs, de Wijn[1413], confirm in writing that, until certain conditions had occurred, the part of the *splitsingswet* which contains the *groepsverbod*, would not be enforced[1414], was the consequence of the fact that according to Article 85 *Grondwet*, the *Eerste Kamer* is not allowed to amend legislation forwarded to it by the *Tweede Kamer*. It can only pass or reject it as a whole. The *motie* also requested that before enforcement the two chambers of Parliament were to be "consulted", which did not, however, require any approval of the Parliament.[1415]

From Article 86 *Grondwet* it follows that a bill can always be withdrawn before it has passed both chambers of Parliament. Further, any bills, which are still in the parliamentary procedure when a new Parliament is elected, do not count as

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1411 See nn. 1309 and 1310 and accompanying text.

1412 See nn. 1309 and 1310 and accompanying text with respect to the details of the conditions and the reasoning of the subsequent Minister of Economic Affairs, van Hoeven, for enforcing the groepsverbod.

1413 The Minister of Economic Affairs, de Wijn, left office because general elections took place in November 2006 and consequently a new government with a new Minister of Economic Affairs, van Hoeven, came into power in February 2007. Minister de Wijn confirmed in writing that he would comply with the entire Motion and "promised" to explicitly bring this confirmation to the attention of his successor as Minister, see in more detail nn. 1309 and 1310 and accompanying text.

1414 By Royal Decree (*koninklijk besluit*), which in the current context is in the sole remit of the government.

1415 See nn. 1309 and 1310 and accompanying text.

withdrawn, i.e. these bills survive elections in the state they were left when Parliament dissolved. This can be inferred from the fact that a law which was submitted by a Member of Parliament who has not been re-elected to the new Parliament, can continue to be promoted in the new *Eerste Kamer* by a Member of the *Tweede Kamer*. Further, a government cannot be bound by a previous government; this can be inferred *e contrario* from the fact that a new government can withdraw a bill submitted by the former government as long as it has not been passed by both chambers of Parliament.[1416]

As a consequence, the question of predictability does not arise here. An Act of Parliament, which could have caused such expectations/belief (that the *groepsverbod* would not be enforced), has never been passed. It does thus not matter in this context whether one or all of the conditions established by the *motie* of the *Eerste Kamer* were fulfilled at the time the *groepsverbod* was enforced because the new government was not bound by its predecessor's confirmation of the *motie*.

Fair balance or proportionality test

For the three legislative measures discussed above not to be in breach of the fundamental right to property according to Article 1 if the First Protocol of the ECHR, they need to strike a fair balance between the State's objectives in the general interest and the private interests of the vertically integrated energy supply undertakings subject to these three measures.

The measures have to be suitable to achieve the general interest aims. On the face of it, all three measures assist in achieving the objectives laid out above. However, some doubts do arise when considering the suitability of the *groepsverbod*:

First, the Netherlands appear to be only the second country so far, after New Zealand, to introduce such far reaching unbundling requirements for its distribution networks.[1417] The development of competition in New Zealand failed, however, with the consequence that there, the ownership unbundled energy industry structure was abolished gradually over a period of some years with ex-ante sector regulation being tightened.[1418]

1416 See nn. 1309 and 1310 and accompanying text.

1417 New Zealand has forced ownership unbundling of the transmission and *distribution* networks onto its energy sector, see already n. 1226.

1418 On the New Zealand experience and reference thereto, see nn. 319, 1227 and accompanying text.

Another New Zealand experience which is confirmed by DTe and by developments in the EU, and which is related to the increase in (household) customer prices, is that after the separation of the retail businesses from the distribution networks, most of these businesses became vertically integrated in the five large generators. Retail competition stopped as soon as vertical integration by the generators was finally accomplished in 2001. This process quickly foreclosed any subsequent retail entry, an effect, which would certainly corroborate the findings of the energy sector enquiry conducted by the European Commission[1419], which confirmed that the energy market was consolidating and suffering from a lack of new market entry.[1420] The DTe had also already found in 2004 that ownership unbundling would lead to a higher concentration in electricity generation and wholesale, and the energy supply markets, with negative consequences for the functioning of the energy markets.[1421]

Secondly, Dutch economists have shown in a *quantitative* social cost and benefit analysis that the *groepsverbod* is likely to result in a negative balance[1422], i.e. that this measure is likely to be inefficient from an economic point of view.[1423] It has also been shown that distribution network ownership unbundling can be detrimental to the development of distributed generation.[1424]

1419 N. 3.

1420 The Commission's policy on vertical and conglomerate mergers needs to be considered in the light of its ongoing concern about the increasing level of concentration in the EU's gas and electricity markets. The Commission regards it as essential to ensure that large-scale mergers do not undermine the liberalisation process by creating an oligopolistic and non-competitive market structure. Critical in this regard, however, Thomas, nn. 317, 1105.

1421 See Brief (letter) van de Dienst uitvoering en toezicht Energie aan de Minister van Economische Zaken, Brinkhorst, 'Advies onafhankelijkheid netbeheer' (advice on network operation independence), 15 April 2004, pp. 4–5.

1422 See Baarsma/de Nooij, n. 38.

1423 This analysis was provided in response to a "mere" *qualitative* social cost and benefit analysis of CPB whose outcome had been ambiguous, see Mulder/Shestalova/Lijesen, n. 37. For further guidance on how ownership unbundling interferes with the current technical structure of the sector, see Finger/Künneke, n. 38. With particular focus on the further unbundling of the Dutch electricity distribution networks, see also R Künneke, T Fens, 'Ownership unbundling in electricity distribution: The case of The Netherlands', (2007) Energy Policy 1920. See also more generally and extensively with respect to the inefficiency of further unbundling measures, the discussion in Part 1 Chapter 2.

1424 See for more detail, Brunekreeft/Ehlers, nn. 8, 38. Distributed generation (more particularly CHP) contributes a large share towards electricity generation in the Netherlands, see n. 1270, and is clearly on the Commission's agenda, see the Commission's Communication 'An Energy Policy for Europe', n. 6, pp. 6 (par. 3.1), 15 (par. 3.6). Further, the more electricity generation is not only pursued "top down" but also "bottom up" (network interdependence), the more intensive cooperation and coordination between (central as well as decentral) generators and the (distribution as well as transmission) network operators is needed. This is stressed by Pielow/Ehlers, n. 35.

And lastly, it is also doubtful whether the general interest in creating a level playing field for all energy suppliers active in the Netherlands for the benefit of consumers is really supported by the *groepsverbod*. This is because no answer has been provided to the question of how such a "level playing field" can be created if some energy suppliers are either horizontally integrated (such as multi-utilities) or possess energy networks abroad, and are cross-subsidized by such means.

Be that as it may, the necessity of the *groepsverbod* also appears doubtful, i.e. there is uncertainty as to the answer to the question of whether there exist less intrusive but similarly effective means to achieve the general interest objectives of the Dutch legislator:

First, some market deficiencies, which are supposed to be put and end to by the *groepsverbod*, have never been proved, such as the claim that vertically integrated distribution network companies impede third party access to its networks.

Secondly, the NMa established in June 2007 that the *groepsverbod* is not necessary to safeguard the independence of the operation of the energy networks. Although it would be the most certain means to ensure the independence from vertical integration, the *groepsverbod* can also not fully exclude the risks to the operation of energy supply networks in an efficient, financially stable and market facilitating manner, which ensures their quality and reliability.[1425]

Thirdly, the NMa has established, also in June 2007, that currently, no cross-subsidization is taking place in the Dutch energy supply sector[1426], and that the chances of cross-subsidization in the future are rather small.[1427]

Lastly, the DTe announced in April 2004, and repeated in June 2007, that alternatives to the *groepsverbod* do indeed exist in the form of further legislation and regulation, which weakens the claim that the general interest lies in less

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1425 NMa, 'Onderzoeksrapport inzake publiek en onafhankelijk netbeheer', no. 102680 / 23, 4 June 2007, pp. 4, 32. The NMa makes it also clear, however, that the stricter application of legal unbundling as agreed between the Dutch energy supply undertakings concerned and the Director of Energy of the Ministry of Economic Affairs in order to prevent the introduction of *splitsing* would not be far reaching enough, see NMa, *ibid.*, p. 3. As this proposal to a considerable extent resembles the so-called "Third way" of "Effective and efficient unbundling" proposal of France, Germany and six other EC Member States in the context of the revision of the current Energy Directives, the findings of the NMa also have some relevance to this.

1426 With respect to the doubtful relevance of cross-subsidies in electricity sector regulation, see Willems/Ehlers, n. 2.

1427 NMa, n. 156.

excessive regulation.[1428] In this context it should be noted that one significant benefit of vertical integration has already been abolished, and this is that according to Articles 93b E-Wet and 85b G-wet energy networks are not to be used any more as collateral or security for financing the integrated competitive activities.

By way of preliminary summary, it can be said that the *groepsverbod* seems not to be conducive to achieving those objectives of general interest which are mainly targeted at remedying the claimed deficiencies of vertical integration, not even the one which aims at retaining the networks and its operation in public hands since for the latter the absolute privatization ban would have sufficed and would have led to the breaking-up of the vertical integration (in any event as soon as the commercial parts of the energy supply undertakings are substantively privatized).

Compensation

Turning to the actual proportionality or the weighing or balancing of the general against the private interest, the main focus of attention here is the question of compensation payable.[1429]

As has been shown, compensation must in principle be paid to the vertically integrated energy supply undertakings concerned because the transfer of the economic "ownership" of the networks they are operating amounts to a deprivation in the form of an expropriation.[1430] Compensation for the

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1428 See letter of 15 April 2004, n. 1421, where it says on p. 3 that requiring integrated network companies to be "fat" would be sufficient. See also p. 4, where alternatives to *splitsing* are discussed. See also NMa, n. 1425, p. 32.

1429 The question whether the *groepsverbod* can be regarded as a normal economic risk, which was to be expected by the energy supply undertakings affected, is not discussed further here. It suffices to indicate that the formal privatization of the energy supply undertakings concerned originally happened with a view to substantively privatizing them at some stage. They were, however, for the time being retained in complete state ownership (by municipalities and provinces), which was tentatively confirmed by the announcement that substantive minority privatization of energy networks might be made possible. Importantly though, substantive privatization always required the consent of the Dutch government. When liberalization started, and with it the introduction and tightening of the unbundling rules, it was not at all clear how far the unbundling would go. It is thus arguable whether the energy supply undertakings concerned could legitimately expect not to be subjected to a *groepsverbod*. More generally on this issue, see the ECtHR in re *Fredin*, n. 1152.

1430 As regards the transfer to TenneT of the right to operate the networks of 110 kV and above which they were operating, which amounts to a deprivation of the right to use such networks and thus to a regulation of the right to property, TenneT already makes capital interest payments (to maintain the value of the assets) to the vertically integrated energy supply undertakings concerned; it is likely that this is regarded as sufficient by the ECtHR to reach a

groepsverbod is, however, not provided for by general law or by the legislation introducing the *groepsverbod*. On the other hand, this should not be too great an issue because, first, the shareholders are likely to have to approve the sale of one or the other activity and, secondly, compensation payable would be merely circular within the public sphere or the state organization anyway.[1431]

As regards the (*de facto*) expropriation as a result of the *groepsverbod*, it is also clear that compensation is to be paid by the receiving parties because they are benefiting directly from the expropriations, i.e. the transfer of property to them; receiving parties in the current context are the public bodies holding the energy supply undertakings expropriated.[1432] The transfer of the economic "ownership" of the networks is to be treated similarly to a private transaction – one exception being that because of the general interest and public budgets involved, one might come to the conclusion that less than the full market value should be reimbursed.[1433] What also needs to be reimbursed are the additional (but unlikely) consequential losses arising from the expropriation, i.e. any claims as a result of a potential breach of cross-border leases.[1434]

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fair balance between the general and the private interest. Thus, no further assessment is necessary in this respect.

1431 However, the conversion of integrated "slim" to integrated "fat" network operators before the deadline for the *groepsverbod* at the end of 2010 already leads to some compensation becoming payable according to Articles 10a(3) E-wet, 3b(3) G-wet. According to Koppenol-Laforce/de Wit, n. 1291, all companies concerned by the *groepsverbod* have chosen for "slim" operators from the outset so that the conversion results in a replacement in the balance sheet of the energy supply holding of the value of the network assets whose economic "ownership" is transferred to the integrated network companies with the compensation set out in the above mentioned Articles.

1432 It has been established above that a deprivation of property in the form of a formal expropriation does not necessarily have to be the result of a transfer made to the State but can also be the result of a transfer for the benefit of third parties. In fact, here the public bodies are not even to be regarded as third parties because they are part of the state organization.

1433 See in this respect also n. 1362. An expropriation without compensation corresponding to the market value can normally, however, be regarded as disproportionate. Even when a "mere" regulation of ownership is at stake, compensation might have to be paid in exceptional circumstances; in this respect, see the discussion reflected in the decision of the German BVerfG in re *Denkmalschutz*, n. 551. A valuable hint as to what might be an appropriate amount of compensation, which also shows the appropriateness of the assumption here that the transfer should be treated in a similar way as a "normal" market transaction between private parties, can be inferred from ss. 10a(3) and 3b(3) E-wet and G-wet, respectively, where the amount of consideration to be paid for the transfer of economic "ownership" of the networks to an integrated network operator is stipulated, see already n. 1431.

1434 This is because in a private transaction, the buyer usually also has to pay for expenses such as those associated with rights *in rem* or other entitlements of third parties with respect to the good transferred. Delta's balance sheet, for instance, confirms that the legal and economic ownership of the networks which are the subject of cross-border leases remains with Delta, see already n. 1315.

To explain why the payment of compensation would be merely circular within the state organization, it should be noted first that there are several ways of transferring the economic "ownership" from the undertakings concerned to their shareholders or to legal persons held by them (outside these undertakings). The straightforward options are transferring the shares in the network company (holding the economic "ownership" of the networks) or in the competitive energy supply companies (generation or energy supply) or executing a so-called split-off (*juridische splitsing*).[1435] One option for the transfer of the shares in the competitive activities is the transfer directly to another (private) market party.[1436]

Both ways (i.e. share transfers and split-off) would have the advantage that no money had to change hands.

As regards a split-off, the municipalities and provinces as shareholders would receive shares in the companies established as a result of the split-off and thus would not have to pay any purchase price. However, it has been established here that compensation is payable in principle as result of the deprivation of economic "ownership", the amount of which should be measured according to a formula based on market value, such as, it appears, the formula set out in ss 10a(3) and 3b(3) E-wet and G-wet, respectively.[1437] On the other hand, as regards a share transfer money still does not have to change hands if a split-off is effected.

In the case where the share transfer option is pursued, the shares which the energy supply holding company owns in its network operation company (which is the economic "owner" of the networks), or, as the case may be, in its competitive energy supply company or companies (if separate for electricity generation and energy supply) would be transferred to the public shareholders or a holding company they have established for that purpose.[1438] In order not to have to transfer the purchase price in consideration, the municipalities and provinces

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1435 For the latter, see ss. 234 *et seq.* of the Second Book of the Dutch Civil Code (Burgerlijk Wetboek, Boek 2). See in greater detail, in particular with respect to the complications a split-off would entail, Roggenkamp, n. 1313, p. 245, and n. 1363, p. 388.

1436 It has already been outlined that, in this respect, privatization is not prohibited. Another way of structuring such a transfer would be by way of an asset deal where only the assets are transferred to a newly incorporated legal person and the "old" legal vehicle would be wound-up.

1437 See already n. 1431.

1438 As already indicated, the purchase price (or compensation) would have to be in line or at least come close to the market value of the economic "ownership" of the energy networks in operation or the commercial activities pursued by the company/-ies whose shares are transferred.

can set off the price against dividends to be paid by the transferring undertaking.

In the case of a split-off as just discussed above, the undertaking against whose dividend the purchase price could *prima facie* be set off would be the company pursuing the commercial energy supply activity. This is *prima facie* so because it is the original aim of the *groepsverbod* to ensure that independent network operation is pursued by the public sector and on publicly owned energy networks. The victims, on the other hand, are the vertically integrated energy supply undertakings whose economic "ownership" of the energy networks has been expropriated (as has been established above). Thus the remaining part of the formerly vertically integrated energy supply undertaking which pursues the competitive energy supply activities has to be compensated for the expropriation of this economic "ownership". Consequently, this compensation (entitlement) should then be set off against dividends paid by this undertaking (entitled to such compensation).[1439] On the other hand, should liabilities arise such as for claims in the context of financing arrangements such as cross-border leases, these would, following the reasoning above, increase the purchase price so that the dividend payment would be (further) deferred.

VI. ARTICLE 56 EC

What remains is the question whether the *groepsverbod* is compatible with two of the fundamental freedoms of the EC Treaty, the free movement of capital according to Article 56 EC and the freedom of establishment according to Article

[1439] Alternatively, the public shareholders could opt for paying the purchase price, which would then be returned to them by way of (interim) dividends. For this and for the problems this option might encounter, see Roggenkamp, n. 1435. For example, the articles of association must provide for such interim payments and there must have been sufficient reserves built up.

43 EC.[1440] This was one of the main subjects of debate during the legislative process leading to the passing of the *splitsingswet*.[1441]

The compatibility of the *groepsverbod* with EC law was, however, criticized at a time when the Dutch government still considered a "minority privatization" (i.e. a privatization by way of allowing the private sector a minority stake) of the network operators feasible[1442], and in legal terms the debate focused primarily on the interpretation of Article 295 EC.

It is indeed necessary to distinguish between a situation where the network operator is in the sole ownership of public shareholders where any privatization at all is prohibited by law and the situation where at least a minority privatization is possible according to the law. This flows from the fact that EC law leaves it to the Member States to decide whether they want to assume an activity and retain it in state ownership. This at any rate is the consequence of the reading of Article 295 EC as understood here and as understood by the European Commission.[1443]

1440 See R Streinz, *Europarecht*, 8rd ed., 2008, nos 895 *et seq.*, as to their distinction, in particular in cases, as here, which are concerned with a combination of investment and privatization issues. In particular in the so-called *Golden Share* cases of the ECJ, which are concerned with special rights in substantively privatized companies which Member States reserve to themselves, the ECJ assesses restrictions to the free movement of capital according to Article 56 EC, thereby only incidentally assessing restrictions of the freedom of establishment, which are inevitably linked to the former. Consequently, here only Article 56 EC will be discussed, if at all. See in greater detail also Part 1 Chapter 3 section V(4) on Article 56 EC, in particular n. 571. With respect to the scope of Article 56 EC, see also S Grundmann, F Möslein, 'Die Goldene Aktie', (2003) ZGR 317, 325 *et seq.*

1441 Most prominently, the Raad van State and Professor P Slot have delivered opinions. For the former, see n. 588, for the latter, see his opinion 'opinie inzake de voorgenomen splitsing van geïntegreerde energiebedrijven en beperkte privatisering van netbeheerders', Universiteit Leiden, 8 September 2006.

1442 Both, the Raad van State and Professor Slot have delivered their opinions against this background. In all of Professor Slot's examples and ECJ case law, which he uses in his Report to support his assumption that the free movement of capital according to Article 56 is (potentially) inhibited, it becomes clear or can be inferred that they are built upon the belief that (minority) privatization will take place in the very near future, based on legislation ["after network operators are allowed to become entirely or partly privatized" (no. 11) or "future freedom to invest in the operation of networks" (no. 13)]. Professor Slot, for instance, refers to the so-called "Golden Shares" case law of the ECJ, all of which deal with special rights of the State in substantially (part) privatized companies, and uses in his examples terminology typically used in a privatized commercial setting, such as "investors" (nos 12, 13), "want to invest" (no. 14) or "(before privatization) […] potential market entrants" (no. 15). Or he looks at the other side of the same coin when speaking about "obstacles in attracting capital" or reverse discrimination of today's shareholders in Dutch network operators whereby his Report is still based on the assumption that German private company RWE is still one of this class of shareholders; this has, however, changed in the meantime so that there are only and exclusively Dutch public shareholders left.

1443 For the first, see Part 1 Chapter 3 section V(1). For the latter, see, for instance, its 'Communication on certain legal aspects concerning intra-EU investment', OJ 1997 C 220/15, 19.7.1997, where

As regards the issue of privatization of energy supply network companies in the Netherlands, it has already been explained that as it stands now, this can only be permitted with the consent of the Dutch Parliament; in democratic systems, there is no stricter hurdle for a (economic) policy issue to overcome. Thus, privatization of network companies is prohibited in the Netherlands until the legislature as sovereign changes its mind.

It is thus questionable whether there would be an interference with the free movement of capital even before the government together with the Parliament have resolved whether or not a (minority) privatization of network operators should be allowed. The claim that minority privatization of Dutch network companies might become possible in the future and the restrictions inherent in the *splitsingswet* are said to have an "influencing effect" on the readiness of investors to invest in the Dutch energy market, and are thus deemed to interfere with the free movement of capital can not be considered relevant in this context. Apart from the fact that the development of policy and regulatory uncertainty are political considerations, and that uncertainty is inherent in the Parliament's legislative or decision making process in democratic societies this claim would conflict with the sovereignty which Article 295 EC leaves to the Member States in the area of property ownership and deprive Article 295 EC of its applicability.

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in note 1, it says: "It should be stressed, in this respect, that the movement of a firm from the *public* to the private *sector* is an economic policy choice which, in itself, falls within the exclusive competence of Member States, stemming from the principle of neutrality in the Treaty *vis-à-vis* the system of property ownership, established in Article 222 EC [currently Article 295 EC, Article 345 after the Treaty of Lisbon enters into force; both with the same wording; emphasis and comment added]." In the Communication of the Commission, 'White Paper on services of general interest', Communication, COM(2004) 374 final, Brussels, 12.5.2004, p. 22 (n. 42), "public sector" is defined as covering "all public administrations together with all enterprises *controlled* by public authorities [emphasis added]." On page 23 of the same document, "public undertaking is normally also used to define the ownership of the service provider. The Treaty provides for strict *neutrality*. It is irrelevant under Community law whether providers of services of general interest are public or private; they are subject to the same rights and obligations [emphasis added]." In Communication from the Commission, 'Service of General Interest in Europe – Executive Summary', OJ 2001 C 17/4, 19.1.2001, no. 21, it is emphasized that "[*n*]*eutrality* as regards the *public* or private *ownership of companies* is guaranteed by Article 295 of the EC Treaty. On the one hand, the Commission does not question whether undertakings responsible for providing general interest services should be public or private. Therefore, it does not require privatization of public undertakings [which reflects the interpretation of privatization as outlined above]. On the other hand, the rules of the Treaty and in particular competition and internal market rules apply regardless of the ownership of an undertaking (public or private) [emphasis added]." Thus, where the State or its subdivisions are invested in private legal entities to a degree where the amount of rights of disposal gives them economic control over the undertaking, this private legal entity is classified as public undertaking in the EU.

The scope of Article 295 EC has already been discussed extensively in Part 1 Chapter 3.[1444] To the extent relevant here, it has been established that Article 295 EC is supposed to ensure that fundamental decisions of economic policy stays in the remit of the Masters of the Treaty, i.e. the Member States, that the national systems of property ownership are to be left untouched, and that the fundamental decisions to nationalize or socialize private sector market activity or, *e contrario*, to privatize public sector market activity fall into the competences of the Member States and not the EC. As measures which are in principle a type of property ownership allocation (i.e. a decision of the State to allocate certain rights, obligation or requirements to certain categories of property), such decisions do not fall under the Treaty rules and thus do not infringe Article 56 EC. Article 295 EC therefore has the effect of barring any decisions of the Community to nationalize, socialize or privatize. This argument is supported by the fact that the EC does not distinguish between public and private undertakings as market actors, which is an indication that the EC is not interested in shifting undertakings from the private into the public sphere or *vice versa*.[1445] As soon, however, as such a fundamental decision is not recognizable anymore as being a property ownership allocation, such as would be the case in situations of part or minority privatization, or as soon as the fundamental decision of privatization of any kind has taken place and been enforced, property ownership has been allocated and the exercise of property ownership becomes relevant again and falls under the Treaty provisions, in particular under Article 56 EC.

As far as the analysis of whether Article 56 EC is applicable to the Dutch *groepsverbod* is concerned, it follows from this interpretation of Article 295 EC that the competence to take fundamental decisions in economic policy such as a privatization belongs to the Dutch State, and only if the Netherlands has decided to undertake a privatization, even if it just entails minority privatization, the law enforcing such privatization falls under the Treaty rules and can be judged against Article 56 EC. Only then, i.e. when (part) privatization is made possible, will all the concerns with respect to the obstacles this might cause to the free movement of capital in the European Union be considered in order to determine how such privatization should be pursued. Because the Dutch legislature has taken the decision not to substantively privatize the energy companies owned by the Dutch State and its municipalities and provinces, which can only be reversed by the Dutch Parliament itself (and not by the Dutch government) based on a law

1444 It may be recalled that Article 295 EC contains a bar on the exercise of competences conferred upon the EC according to which the "Treaty shall in no way prejudice the rules in Member States governing the system of property ownership."

1445 See further *infra*, chapter 7 on the European Union.

which specifically provides for privatization[1446], Article 56 EC does thus not apply.[1447]

VII. CONCLUSIONS

Historically, energy supply in the Netherlands is state-dominated, energy distribution and supply to consumers is traditionally run by municipalities and provinces as subdivisions of the Unitary Dutch State, which do not possess an institutional guarantee similar to comparable subdivisions in a Federal State such as Germany.

Only from the perspective of the public shareholders of the energy supply holding companies can the *groepsverbod* be perceived as an alternative form of organizing property and thus as a mere regulation of property, which is to be regarded as a form of legal unbundling requiring the breaking-up of the holding companies and arranging the separate parts differently; from such a viewpoint, Dutch municipalities and provinces as ultimate owners would indeed not be deprived of "their" property (i.e. property they hold as administrators of the State).[1448] As the holding companies are, however, the (potential) complainants in this context, this perception is irrelevant here. The Dutch public shareholders can, however, not claim victim status (i.e. fundamental rights protection) under the ECHR and are not institutionally protected as comparable public institutions in Federal States such as Germany are, which would be able to take legal action against such interferences of the State.[1449]

1446 Even under conditions set out in such a law, which are not under parliamentary control.

1447 Contra the Rechtbank 's Gravenhage, n. 574, which subjects every state measure, which organizes property ownership (i.e. is allocation as well as its regulation) to the EC Treaty rules and thus also to Article 56 EC. The Court does, however, not sufficiently reflect the aspects considered here in the context of the discussions of Article 295 EC and Article 56 EC.

1448 This is the official view of the Dutch government, as a result of which no compensation was provided for in the *splitsingswet*, see *memorie van toelichting*, n. 1294, pp. 44–5 (no. 7.3).

1449 In Germany, a privatization ban or a general privatization of municipality owned vertically integrated energy supply undertakings would probably be justifiable if it was in the general interest, even though municipalities enjoy institutional protection according to Article 28(2) GG. In the case of interferences with the institutional rights conferred by Article 28 GG, the BVerfG applies a "Vertretbarkeitsprüfung", which is a "reduced" test compared to a fully fledged proportionality test applied if fundamental rights are at stake. The privatization of energy networks only would probably not pass this test if private vertically integrated energy supply undertakings were allowed to retain their energy networks. A general privatization is, however, unlikely to take place because if it turned out to be a failure the German State might have to undo it because of its residual ("last resort") responsibility to guarantee energy supply ("Gewährleistungsverantwortung").

The case of distribution ownership unbundling is a highly political one, which does not lend itself to fundamental rights claims. The assumption followed here that undertakings with legal personality owned or controlled by public institutions can claim victim or complainant status is used to show that in principle these undertakings enjoy the same protection under the ECHR when participating in (competitive) market activities as every private undertaking.

In the special case of the Netherlands, affording the holding companies of the Dutch publicly owned energy supply undertakings victim status under the ECHR is, however, of no practical use for them[1450] and shows the artificiality of the discussion as to whether a private legal entity in 100% state or municipal ownership should be able to rely on fundamental rights protection (without an institutional protection of their municipal shareholders similar to Article 28 GG).[1451] This is because undertakings *wholly* owned by a Unitary State such as the Netherlands (or its subdivisions) would not be able to recover or, better, to keep compensation payable and thus to receive an adequate substitute for the assets they have been deprived of; any compensation paid would only be shifted back and forth within the state organization and be effectively cancelled out.

To avoid the sale of the energy networks and their operation to foreign parties, it would have been sufficient just to enforce the absolute prohibition of privatization without imposing the *groepsverbod*, as has been done (inconsistently) with respect to the electricity networks from 110 kV upwards, the economic "ownership" (or even legal ownership) of which can continue to stay with the energy supply undertakings. The prohibition of privatization without the *groepsverbod* in those cases results in such networks remaining in public ownership upon the sale of the commercial energy supply activities.

As regards the other objectives of general interest, it appears doubtful whether the *groepsverbod* helps in achieving them. Even the objective of creating a so-called level playing field, i.e. that no undertaking active in competitive energy supply in the Netherlands is allowed to hold and operate energy networks, is unlikely to be achieved by enforcing the *groepsverbod*. Not only do the networks, albeit not vertically integrated, remain owned by the same shareholders who own the holding company of the (remaining) vertically integrated energy supply undertaking, i.e. the municipalities and provinces, but also it was not sufficiently

1450 The Rechtbank 's Gravenhage, n. 574, ruled that Article 1 of the First Protocol of the ECHR is not infringed by the *splitsingswet*. Although this is in accordance with the findings of this work, the underlying reasoning appears to be highly questionable.

1451 It is also of no avail because although they can, again in principle, rely on Article 56 EC, Article 56 EC is not applicable according to the reading of Article 295 EC followed here.

taken into consideration that market concentration and vertical integration with respect to generation and supply is likely to increase, and that horizontal integration, for instance, in a multi-utility setting, can lead to cross-subsidizing competitive energy supply activities (for example by the use of assets, which are not related to energy networks, as security for the financing of these competitive activities).

The Netherlands are a good case study in another respect, however, and this is that the ongoing construction of and the opening of new gas and electricity interconnectors, partly regulated and partly merchant, in combination with the development of the regional northwest European gas and electricity markets and the Pentalateral Forum, are practical steps towards an internal market for energy supply, which already display tangible results even though integrated TSOs are involved.

CHAPTER 7
EUROPEAN UNION

I. INTRODUCTION

This chapter on the protection of fundamental economic rights in the European Union will be kept rather short because the area of jurisprudence which it covers largely resembles that of the ECHR as construed by the ECtHR, which has already been discussed in the previous chapters.

However, important differences in detail such as the explicit recognition by the ECJ of the freedom to pursue an economic activity or to pursue a trade or business and the corresponding stipulation in the European Charta of Fundamental Rights of the freedoms to choose (and pursue) an occupation and to conduct a business will be discussed on this chapter. The question of whether public law corporations or private undertakings controlled by public entities enjoy protection under EC law will be answered. Further, the compliance of the Commission's proposals with the general principle of equality in the context of labelling the transfer of energy transmission networks from such vertically integrated energy supply undertakings as ownership unbundling, which are controlled by the State or other public entities to organisationally separate public entities will be discussed in greater detail.

The extent to which the proportionality principle is applied by the ECJ will also be an issue to look into more extensively, in particular in comparison with the judicial deference paid by the ECtHR to the signatories of the ECHR. In the context of dealing with the proportionality principle, the allocation of the responsibility to provide for compensation for fundamental rights interferences liable to compensation will also be briefly discussed there. Further, as has already been explained in the context of the proportionality of further unbundling measures by way of competition law enforcement, the principles discussed there will also apply to the further unbundling measures introduced by EC legislation and thus the elaborations in this regard kept rather short.[1452]

[1452] The economic analysis of competition law enforced divestiture of individual energy supply networks and their operation when controlled by vertically integrated energy supply undertakings is similar to such an analysis in the context of ownership unbundling imposed on the entire sector by way of sector-specific regulation. This is so because of the natural

II. FUNDAMENTAL RIGHTS ISSUES ARISING IN CONTEXT OF FURTHER UNBUNDLING LEGISLATION

The Charter of Fundamental Rights of the European Union (ECFR) of 7 December 2000[1453], which the European Parliament, the European Council and the European Commission have declared binding on themselves, has explicitly been accepted by the ECJ as interpretation tool.[1454] Accordingly, not only will the case law of the ECJ be referred to in the course of this chapter but also reference will be made to the ECFR.[1455]

1. RIGHT TO PROPERTY

The fundamental right to property has long been recognized by the ECJ as one of the general principles of Community law[1456], based on Article 1 of the First Protocol of the ECHR and the constitutional traditions common to the Member States.[1457] The right to property is also set out in Article 17 ECFR.[1458]

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monopoly character of such networks and the fact that energy transmission networks and their operation, which would be the target of divestiture and regulatory ownership unbundling, are controlled by one or only very few undertakings in each Member State, and interconnectors normally only by one undertaking.

1453 OJ C 303/1, 14.12.2007.

1454 ECJ, C-540/03 – *Parliament* v *Council*, (2006) ECR I-5769, nos 38, 58. As regards the level of protection of fundamental rights, a high standard of protection such as, for instance, in Germany should be respected instead of relying on the lowest common denominator of the different levels of fundamental rights prteoction available in the Member States. This contention seems to be by Article 53 ECFR, which states: "*Nothing* in this Charter shall be interpreted as *restricting* or adversely affecting *human rights and fundamental freedoms as recognised*, in their respective fields of application, by Union law and international law and by international agreements to which the Union or all the Member States are party, including the European Convention for the Protection of Human Rights and Fundamental Freedoms, and *by the Member States' constitutions* (emphasis added)."

1455 For the relationship of the rights guaranteed by the ECFR and the ECHR, see Article 52(3) ECFR: "In so far as this Charter contains rights which correspond to rights guaranteed by the Convention for the Protection of Human Rights and Fundamental Freedoms, the meaning and scope of those rights shall be the same as those laid down by the said Convention. This provision shall not prevent Union law providing more extensive protection.

1456 ECJ, C-44/79, n. 536; C-280/93, n. 241, nos 77 *et seq.*; C-293/97 – *Queen* v *Secretary of State for the Environment*, (1999) ECR I-2603, no. 54; Joined Cases C-154/04 and C-155/04 – *Queen* v *Secretary of State for Health*, (2005) ECR I-6451, no. 126.

1457 See now also Article 6(2) EU: "The Union shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms […] and as they result from the constitutional traditions common to the Member States, as general principles of Community law."

1458 Article 17(1) states: "Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the

The Community right to property protects the possession of an acquired or existing legal position in the hands of the rights owner and the rights to use to dispose of such possessions or legal positions.[1459] The acquisition of property is not protected until a secured entitlement to acquire property exists.

As property rights are conferred to their owners by law, the extent of such legal positions depends on the relevant provisions in national and Community law.[1460] Further, only such legal positions are protected as can be allocated to their holders and find their basis in the law. Thus, mere commercial interests such as (the preservation of) market shares and prospects, chances in the market and opportunities to earn money are not included.[1461]

As regards the latter, these are usually protected by other economic fundamental rights such as the freedom to choose and pursue an occupation or the freedom to pursue an economic activity or to conduct a business.[1462] On the other hand, legal positions, the enjoyment of which can be *legitimately* expected (*Vertrauensschutz*), are also likely to be protected by the right to property.[1463]

a. Subject-matter of protection

Based on a broad definition of property, any proprietary rights and interests (assets resulting from legal entitlements) are protected[1464], which can be attributed

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public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest." There are some differences in formulation but not in substance compared to Article 1 of the First Protocol of the ECHR; the same is true for the issue of compensation, which is explicitly set out in the ECFR but not in the ECHR where, however, the ECtHR has developed similar principles, see chapters 5 and 6 on Great Britain and the Netherlands. See in greater detail, H Jarass, 'Der grundrechtliche Eigentumsschutz im EU-Recht', (2006) Neue Zeitschrift für Verwaltungsrecht (NVwZ) 1089, 1090.

1459 See also Introduction, also as regards the control of property. See also Jarass, n. 1458, pp. 1091–2.

1460 See Jarass, n. 1458, p. 1092.

1461 ECJ, C-4/73, n. 536, no. 14, Joined Cases C-154, 205, 206, 226 to 228, 263 and 264/78, 31, 39, 83 & 85/79 – *Ferriera Valsabbia* v *Commission*, (1980) ECR I-907, no. 89.

1462 ECJ, C-280/93, n. 241, nos 79.

1463 See ECtHR, *Pine Valley*, n. 1157, no. 51; Cremer in Marauhn/Grote, n. 928, ch. 22, no. 30.

1464 ECtHR, *Gasus Dosier- und Fördertechnik GmbH* v *The Netherlands*, 23 February 1995, Ser. A 306-B, no. 53: "The Court recalls that the notion "possessions" […] in Article 1 of Protocol No. 1 (P1-1) has an autonomous meaning which is certainly not limited to ownership of physical goods: certain other rights and interests constituting assets can also be regarded as "property rights", and thus as "possessions", for the purposes of this provision (P1-1). In the present context it is therefore immaterial whether [the] right to the concrete-mixer is to be considered as a right of ownership or as a security right in rem. In any event, the seizure and sale of the concrete-mixer constituted an "interference" with the applicant company's right "to the

to a person in such a way that this person is competent to exercise all powers related to such rights and interests on his own authority and for his very own private benefit. Only legitimately acquired and valid rights and interests are protected.[1465] Such rights and interests cover physical assets and other rights *in rem* and relative rights such as contractual claims of any value, which, however, have to be enforceable.[1466] The latter rights thus also include capital participations such as shareholdings and similar entitlements such as other rights of participation in companies by way of company law.[1467]

The right to an undertaking in its entirety (*Recht am eingerichteten ausgeübten Gewerbebetrieb*), which not only includes the protection of individual assets of an undertaking such as machines but also the goodwill or the customer base[1468] (or more broadly, the going concern of an undertaking), an essential part of which is the legitimate expectation of a certain level of profit from one's property[1469], seems also likely to enjoy protection.[1470] This can be inferred from statements of the ECJ in re *Flughafen Hannover-Langenhagen I*, which seem to accept the right to make a profit as part of the right to property.[1471]

b. Deprivation

Similar to Article 1 of the First Protocol of the ECHR, Article 17 ECFR distinguishes between the deprivation of property and the regulation of the use of property.[1472]

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peaceful enjoyment" of a "possession" within the meaning of Article 1 of Protocol No. 1 (P1-1)." See in greater detail Jarass, n. 1458, pp. 1089, 1090.

1465 ECtHR, *van Marle*, n. 1155, nos 40–1; see in greater detail Jarass, n. 1458, pp. 1089, 1090.

1466 See ECJ, C-84/95 – *Bosphorus Airways* v *Minister for Transport*, (1996) ECR I-3953, nos 19 *et seq.*

1467 Although there is no corresponding case law of the ECJ on this issue, the ECtHR in re *Lithgow*, n. 1179, no. 107, has granted such protection, which thus bears relevance for EC law according to Article 6(2) EU. See also Schmidt-Preuß, n. 241, p. 468.

1468 Recognized by the ECtHR in *Olbertz (tax consultant) v. Germany*, no. 37592/97, not published but referred to in (2001) Neue Juristische Wochenschrift (NJW) 1558 (translation available in the Court's database HUDOC), which relates to the fact that the ECHR does not include the right to choose and pursue an occupation or the right to pursue an economic activity. See also ECtHR, *van Marle*, n. 1155, and *Latridis*, n. 1152, n. 54. The ECJ, on the other hand, seems to extend the protection of the right to property to undertakings whose very existence is under threat, see ECJ, C-363/01, n. 512, nos 55, 58; C-2/92 – *Queen* v *Ministry of Agriculture*, (1994) ECR I-955, no. 14.

1469 See, however, nn. 1459 *et seq.* and accompanying text.

1470 See chapters 5 and 6 on Great Britain and the Netherlands. See also Jarass, n. 1458, p. 1091.

1471 ECJ, C-363/01, n. 512, no. 55: "As to the right to property, the [prohibition] to collect an access fee does not mean […] that [there is a deprivation] of the possibility of profiting from the economic services that [are provided] on the groundhandling market to which […] access [is to be granted]." Similar also ECJ, Joined Cases C-20/00 and C-64/00, n. 241. See also n. 1505 and accompanying text.

1472 See also section IV(1)(b) of chapter 5 on Great Britain.

The deprivation of property is the complete and permanent loss of ownership, which can happen either by way of formal expropriation where the ownership of a certain property is transferred to the State or third parties[1473], or by way of *de facto* expropriation where the formal ownership position remains intact but where the owner loses all rights attached to his position resulting in a *de facto* loss of ownership; to establish such *de facto* expropriation, however, it requires that the owner is excluded from any meaningful use of, or disposing of, his property (otherwise it would be a mere regulation of the use of property).[1474] Accordingly, the ECJ by taking a rather formalistic view has rejected a claim in respect of deprivation of property in the context of an extensive restriction of the use of property because the owner was still able to dispose of his property albeit for a much reduced purchase price.[1475]

Further, Article 17 ECFR deals with the regulation of the use of property. Such regulation of use are sovereign measures, which mandate or prohibit a certain use of property[1476], and differs from the deprivation of property in that it does not require the transfer of ownership.[1477] It can thus be said that the regulation of

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1473 ECtHR, *Sporrong & Lönnroth*, n. 1183, no. 63. Cremer in Marauhn/Grote, n. 928, ch. 22, no. 88. The destruction of the entire infected fish stock such as in Booker Aquaculture, however, is not regarded as a deprivation of property, and can even happen without payment of compensation, see ECJ, Joined Cases C-20/00 and C-64/00, n. 241, nos 79 *et seq.* The deprivation of prooperty for the benefit of private parties is possible if it also serves the public interest, see ECtHR, *James*, n. 1163, nos 41, 45, Cremer in Marauhn/Grote, n. 928, ch. 22, no. 129. Because of the political, economic and social relevance, the legislature possesses a margin of appreciation for its judgement as to whether a deprivation of property serves the public interest, see Jarass, n. 1458, p. 1093. See also *infra*.

1474 ECtHR, *Sporrong & Lönnroth*, n. 1183, no. 63, *Fredin*, n. 1152, no. 45, *Papamichalopoulos*, n. 1160, nos 43 *et seq.* See also Cremer in Marauhn/Grote, n. 928, ch. 22, no. 95. For a mere regulation of the use of property, see ECJ, C-44/79, n. 536, no. 19, ECJ, Joined Cases C-20/00 and C-64/00, n. 241, and Joined Cases C-172 & 226/83, *Hoogovens* Gröp v Commission, (1985) ECR 2831, no. 29.

1475 ECJ, C-44/79, n. 536, no. 19. *De facto* expropriation under EC law thus is much narrower than the German interpretation of expropriation, which is much more orientated at the loss of substance of the ownership position. In this respect, see Pielow/Ehlers, n. 35, and Jarass, n. 1458, p. 1092. See also the German BVerfG's view in BVerfGE 58, 137, 147 *et seq.*, and in re *Denkmalschutz*, n. 551, on the type of regulation of ownership (*Inhalts- und Schrankenbestimmung*), which amounts to a complete or substantial deprivation of property similar to an expropriation.

1476 The right to property is not an absolute right but must be considered in relation to its social function, see ECJ, Joined cases C-248/95 & C-249/95 – *SAM Schiffahrt* v *Germany*, (1997) ECR I-4475, no. 72; C-368/96 – *Queen* v *Licensing Authority*, (1998) ECR I-7967, no. 79; C-295/03 P – *Alessandrini* v Commission, (2005) ECR I-5673, no. 86. Restrictions of the right to property must be in the general interest, ECJ, C-295/03 P, *ibid.*, no. 86; the regulation of the use of property is also possible in order to protect the rights and freedoms of third parties.

1477 If, however, regulation led to an equivalent effect, *de facto* expropriation would be the consequence.

the use of property is a deprivation of certain limited ownership competences but not a deprivation of the entire ownership position.[1478]

c. Subject of protection

Both natural persons and legal persons can be entitled to fundamental rights protection, the latter, however, only to the extent that the essence of the fundamental right in question can be applied to them. Particularly questionable in the context of economic fundamental rights protection is whether public entities and legal persons, in which public entities hold stakes, can enjoy fundamental rights protection. This issue has already been discussed extensively in the chapters on Germany and the Netherlands. Below, it will therefore be explored whether such entities and legal persons can enjoy protection under EC law.

aa. Private subjects

Any natural person (no matter of which nationality he is) is entitled to protection of the right to property as protected under EC law. Further, following Article 1(1) of the First Protocol of the ECHR, private (corporate) legal persons are also protected under EC law.[1479] The entitlement of private legal persons to fundamental rights protection is not problematic as long as their shares are held by private (natural or legal) persons[1480], who are themselves protected as regards their shareholdings.[1481]

1478 See also n. 1474 and accompanying text.

1479 In this regard also ECJ, C-265/87, n. 238, nos 13 *et seq.*; Joined Cases C-143/88 & C-92/89 – *Zuckerfabrik Suederdithmarschen* v *Hauptzollamt Itzehoe* & *Zuckerfabrik Soest GmbH* v *Hauptzollamt Paderborn*, (1991) ECR I-415, nos 72 *et seq.*; C-200/96 – *Metronome Musik* v *Music Point Hokamp*, (1998) ECR I-1953, nos 21 *et seq.*; C-368/96, n. 1476, nos 61 *et seq.*; Joined Cases C-20/00 and C-64/00, n. 241, nos 66 *et seq.* See also Article 48 EC, which is concerned with the EC fundamental freedom of the right to establishment as set out in Articles 43 *et seq.* EC, and which is a reflection of the fundamental right to pursue an economic activity. Article 48 EC reads: "(1) *Companies or firms formed in accordance with the law of a Member State* and having their registered office, central administration or principal place of business within the Community *shall*, for the purposes of this Chapter, *be treated in the same way as natural persons* who are nationals of Member States. (2) 'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other *legal persons governed by public or private law*, save for those which are non-profit-making (emphasis added)."

1480 L Crones, *Grundrechtlicher Schutz von juristischen Personen im europäischen Gemeinschaftsrecht*, Nomos, Baden-Baden, 2002, p. 175; M Nauschütz, *Das Unbundling integrierter Erdgasunternehmen – rechtliche Grenzen europäischer Wirtschaftsregulierung*, Nomos, Baden-Baden, 2005, p. 234.

1481 In this regard, see also n. 905.

bb. Public subjects

More difficult to answer, however, is the question of whether vertically integrated energy supply undertakings are protected if they are either *Eigengesellschaften*[1482] of the state or other public entities such as municipalities or public law corporations, or private undertakings, in which the State of other public entities hold stakes.[1483]

In principle, public entities, legal persons or corporations under public law and private legal persons wholly owned by such public entities are not able to invoke fundamental rights such as the right to property if their property is at stake. The State and its subdivisions are only addressees of fundamental rights, which means they are under the duty to respect such rights.[1484]

On the other hand, public entities or private entities controlled by public entities[1485], which do not have any sovereign powers or are not competent to exercise state authority[1486], and which are to a large extent autonomous, might be in a different situation, i.e. subject to protection of their right to property.[1487]

1482 See chapter 4 on Germany, n. 789 and accompanying text, and n. 935 on the question of whether in a German context wholly publicly owned undertakings such as *Eigengesellschaften* and other forms of legal persons in complete public ownership should enjoy fundamental rights protection if they take part in competitive energy supply.

1483 Public private undertakings or *gemischt-wirschaftliche Unternehmen*, see chapter 4 on Germany.

1484 See chapter 4 on Germany, n. 921 and accompanying text.

1485 See Article 48(2) EC and n. 1479.

1486 Energy supply does not entail the necessity to exercise sovereign powers, see chapter 4 on Germany, n. 935. Many formerly exclusive tasks of the State and the public administration have been privatised. See also BVerfGE 107, 59, 93 *et seq*., which confirms that services of general (economic) interest do not necessarily have to be performed by the State. In the area of energy, economic activity subject to special public service obligations are, for example, connection and access to energy networks and supply and other universal service obligations. With respect to both, in Germany, for instance, there is a general obligation to connect according to s. 18 EnWG and/or the obligation to provide basic supply of energy (*Grundversorgungspflicht*) according to s. 36 EnWG; in greater detail, see chapter 4 on Germany, n. 760. Private entities, shares of which are (directly or indirectly) held by foreign public entities, such as EnBW where state owned French EDF is invested, naturally do not have any sovereign powers in Germany, and they are not regarded as German public shareholders and thus not bound to obey fundamental rights as German public entities are, see already chapter 4 on Germany, nn. 651, 943 and accompanying text, n. 961.

1487 See chapters 4 on Germany and 6 on the Netherlands. See also ECtHR, *Holy Monasteries*, n. 1169, no. 52; Cremer in Marauhn/Grote, n. 928, ch. 22, no. 61; Jarass, n. 1458, p. 1092. According to Fehling, n. 910, p. 92, undertakings should be able to rely on fundamental rights protection as long as they do not pursue an objective which can solely be fulfilled by the State and its administration (*Verwaltungsmonopole*), but which participate in competition like privately controlled undertakings and which are bound by the same competitive obligations. See also chapter 4 on Germany.

The ECJ has not yet ruled on the entitlement of such public undertakings to fundamental rights protection.[1488] It is likely, however, that the Court would recognize such an entitlement.[1489] This is so because the EC Treaty's character is primarily economic in nature and there are several provisions in the Treaty which indicate that EC law relies on a functional understanding of undertakings.[1490]

Accordingly, in order for undertakings to be entitled to fundamental rights protection, ownership entitlements with respect to such undertakings are not important but only their participation or activity in the market in the same way as every (other) private undertaking.[1491] Only those undertakings, which fulfil

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1488 The EC Treaty is strictly neutral towards public and private ownership of economic actors. The question of whether an undertaking is public or private is not decided by formal terminology but by economic reality. In this respect, the State is treated like every private investor: The 'Communication of the Commission on certain legal aspects concerning intra-EU investment', OJ 1997 C 220/15, 19.7.1997, in note 1 says: "It should be stressed, in this respect, that the movement of a firm from the *public* to the private *sector* is an economic policy choice which, in itself, falls within the exclusive competence of Member States, stemming from the principle of neutrality in the Treaty *vis-à-vis* the system of property ownership, established in Article 222 EC [currently Article 295 EC, Article 345 after the Treaty of Lisbon enters into force; both with the same wording; emphasis and commentary added]." In the Communication from the Commission, 'White Paper on Services of General Interest', Communication, COM(2004) 374 final, Brussels, 12.5.2004, p. 22 (n. 42), "public sector" is defined as covering "all public administrations together with all enterprises *controlled* by public authorities [emphasis added]." On page 23 of the same document, "public undertaking is normally also used to define the ownership of the service provider. The Treaty provides for strict *neutrality*. It is irrelevant under Community law whether providers of services of general interest are public or private; they are subject to the same rights and obligations [emphasis added]." In the Communication from the Commission, 'Service of General Interest in Europe – Executive Summary', OJ 2001 C 17/4, 19.1.2001, no. 21, it is emphasized that "[*n*]*eutrality* as regards the *public* or private *ownership of companies* is guaranteed by Article 295 of the EC Treaty. [...] *The rules of the Treaty and in particular competition and internal market rules apply regardless of the ownership of an undertaking (public or private)* [emphasis added]." Thus, where the State or its subdivisions are invested in private legal entities to a degree which gives them economic control over the undertaking, this private legal entity is classified as a public undertaking in the EU. See chapter 6 on the Netherlands, nn. 1269, 1443. In the so-called *Edison* case, the ECJ recognized that both private and public undertakings are protected by the freedom of the free movement of capital, Article 56 EC, see ECJ, C-174/04 – *Commission* v *Italy*, (2005) ECR I-4933, no. 32. More extensively the position of the Commission, which emphasizes in the last sentence of its Communication on Services of General Interest cited (and emphasized) before that not only the competition and internal market rules of the Treaty apply to both private and public undertakings but the complete body of rules of the EC Treaty.

1489 In C-363/01, n. 512, nos 55, 59, the ECJ has in principle accepted the entitlement of public private undertakings (*gemischt-wirschaftliche Unternehmen*) to fundamental rights protection when evaluating whether the airport's right to property (and the freedom of economic activity) had been infringed.

1490 See Nauschütz, n. 1480, p. 235, and Crones, n. 1480, pp. 176 *et seq.*; Müller-Michaels, n. 535, p. 43.

1491 See n. 1488. See also Nauschütz, n. 1480, p. 235, and Crones, n. 1480, pp. 178 *et seq.*

exclusively sovereign state tasks, would not enjoy fundamental rights protections. Since liberalization energy supply is no longer a task genuinely conferred upon the State[1492], and vertically integrated energy supply undertakings would thus generally be entitled to fundamental rights protection.

Other voices, however, based on the view that the State as addressee of fundamental rights protection cannot at the same time also be subject to fundamental rights protection, insist that the entitlement to fundamental rights protection does indeed depend on who holds an interest in such undertakings. Undertakings controlled by the State or other public entities (even where there is private sector participation) would accordingly not enjoy EC fundamental rights protection.[1493] They argue[1494] that should public undertakings be afforded fundamental rights protection, EC Member States would favour themselves, which contravened the purpose of (economic) fundamental rights as a defence against state interference. Against the background of the high density of economic regulation in the EU, a clear separation of the sovereign powers of the Member States from those of the EU would not exist and thus the danger of confusion as to who is entitled to fundamental rights protection and who is the addressee of such protection would continue to exist. The argument that any undertaking competing in the common market is subject to the same rules and thus the same interferences with their legal rights is true to the extent that competition law is part of the legal order, which all state authorities and institutions are bound to, and accordingly all legal persons controlled by the Member States and their sovereign powers are also so bound. To construe an entitlement to fundamental rights protection based on the obligation to comply with the legal order, however, ignores that the State remains the State even if it pursues its tasks through undertakings controlled by it. In this respect, the State cannot escape its obligations by participating in private energy supply undertakings. It is also argued that public undertakings (in particular those, which are public law corporations) do not fully benefit from the EC fundamental freedoms such as the right to establishment and free movement of services in that these freedoms do not confer upon those undertakings the right (to be enforced against the respective Member States as "owners" in the case of public law corporations) to

1492 Except, for instance, energy network activities in the Netherlands.

1493 See, for instance, D Ehlers, 'Verbot der Diskriminierung wegen der Staatsangehörigkeit', in D Ehlers (ed.), *Europäische Grundrechte und Grundfreiheiten*, 2nd ed., 2005, § 13. According to those (other) voices, EC fundamental rights protection is to be distinguished from the protection by the EC fundamental freedoms, see with regard to the latter, n. 1488 and, mentioned there, ECJ, C-174/04.

1494 For an overview of the arguments to follow, see Blanke in Tettinger/Ster, *Kölner Gemeinschaftskommentar zur Europäischen Grundrechte-Charta*, 2006, Article 16, nos 15 *et seq.*, with further references.

exit the market, as they do for private undertakings. Further, because public undertakings, it is argued, do not benefit from fundamental rights protection, those rights cannot be restricted by law (in contrast to the scope of their functions, which is established by law). Another argument against the entitlement of public undertakings to fundamental rights protection is based on Article 36 ECFR, according to which the EU recognises and respects the right to access to services of general economic interest as provided for in national laws and practices, in accordance with EC law. It is claimed that such services are normally provided by public undertakings, which are obliged to grant access to such services according to national law; they would thus not be able to invoke fundamental rights protection.

Aside from the arguments in favour of the protection of fundamental rights of public undertakings set out earlier in this subsection, the arguments of the opposition to such protection should not be followed for several reasons: Member States cannot give themselves an unfair advantage because the undertakings they control participate in the market like everybody else and are subject to the same rules. Further, private undertakings with public shareholders do have enforceable rights, which they are able to claim against "their" public shareholders/owners.[1495] Further, there is indeed a clear separation between the sovereign powers of the Member States and the sovereign powers of the EU as can, for instance, be recognized when looking at the competition law enforcement powers of the Commission or the fact that the Member States have to apply or implement EC legislation. In this context, a clear distinction must be made between the State acting in its sovereign function and the State participating and competing in the market as every other (private) market player. The opponents of fundamental rights protection for public undertakings, while claiming that the addressee of fundamental rights protection cannot at the same time be entitled to such protection, do not take into account that there are also tasks which no longer fall into the sole remit of the State, such as energy supply.[1496] It further needs to be borne in mind that the EC legal order does not distinguish between private and public undertakings, and that private and public actors competing in the common market are both bound by the same (competition) rules. Thus, the alleged "escape" of the State into private law does not change anything with respect to the obligations of all competitors in the common market to abide by the EC legal order, even if they are States actors. The opponents of protection for public undertakings also seem to misconceive the rules of company law, according to which the shareholders, and thus also public shareholders, determine the entry *and* exit of "their" (private) undertakings. Although it is correct that the market

[1495] As has been shown in the chapter 6 on the Netherlands.

[1496] See already at n. 1486.

entry of public undertakings in the form of public law corporations is established by law (enacted by their public "owners" or the competent legislatures) this economic activity can equally be terminated by law (by those public "owners" or legislatures).[1497] Relying on the gist of Article 36 ECFR does not work for energy supply because ever since energy supply has been liberalized private undertakings have also provided energy supply as a service of general economic interest and are normally equally obliged in the same way as public undertakings to provide such services.[1498]

In conclusion, it appears likely that public entities or private undertakings, in which public entities participate, are able to rely on EC fundamental rights protection of the right to property and the right to pursue an economic activity when they carry on the business of energy supply. However, they can only rely on these fundamental rights as long as they pursue the economic activity of energy supply, i.e. as long as it has not been legitimately terminated (or privatized) by the State. Thus, in this respect public energy supply undertakings enjoy the right to continuance (*Bestandschutz*), which preserves the status quo, to a lesser extent than their private competitors.

Another important aspect to consider in the context of fundamental rights protection of public undertakings from the point of view of EC law is that private undertakings in one Member State, which are owned by shareholders controlled by another Member State (such as French EDF as shareholder of EnBW and Swedish Vattenfall as owner of Vattenfall Europe in Germany)[1499] would have an advantage over the "native" public energy supply undertakings if such private undertakings enjoyed protection but the public undertakings did not. This would be in breach of the general principle of equality, which is another general principle of EC law, and which is further discussed in a slightly different context below.

d. Margin of appreciation and proportionality

The proportionality principle is one of the general principles of Community law[1500], which is also enshrined in Article 5 EC and in the Protocol on the

[1497] Issues such as the lack of the ability to use insolvency procdures on the part of public entities are a matter of enforcing the EC State Aid rules according to Articles 87 *et seq.* EC. Whether, how and when legal persons under public law (are allowed to) pursue an economic activity depends on the relevant legislation. Limitations imposed on such economic activity can normally not be fended off by invoking fundamental rights protection. See chapter 4 on Germany, n. 934.

[1498] And as can, for instance, be observed under German law, see n. 1486.

[1499] See chapter 4 on Germany, n. 943 and accompanying text, n. 961.

[1500] ECJ, C-265/87, n. 238, nos 21, 22: "(21) The Court has consistently held that the principle of proportionality is one of the general principles of Community law. By virtue of that principle,

application of the principles of subsidiarity and proportionality annexed to the Amsterdam Treaty[1501], and set out Article 52 ECFR[1502]; it largely follows the proportionality principle developed in Germany.[1503]

According to the standard formula used by the ECJ as the basis on which, formally, the proportionality assessment of restrictions of the economic fundamental rights such as the right to property and the freedom to pursue a trade or business (freedom to pursue an economic activity) is made, such rights as general principles of Community law are not absolute "but must be viewed in relation to their social function"[1504] and, thus, "may be restricted, particularly in the context of a common organization of a market, provided that those restrictions in fact correspond to objectives of general interest pursued by the Community and do not constitute [with respect to the aim pursued] a disproportionate and intolerable interference, impairing the very substance of the rights guaranteed."[1505]

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measures […] are lawful provided that the measures are *appropriate* and *necessary* for meeting the objectives *legitimately* pursued by the legislation in question. Of course, when there is a choice between several appropriate measures, the *least onerous measure* must be used and the charges imposed must *not* be *disproportionate* to the aims pursued. (22) However, *with regard to judicial review of compliance with the abovementioned conditions*, it must be stated that [where] the Community legislator has a discretionary power which corresponds to the political responsibilities imposed by [the EC Treaty] […], the legality of a measure […] can be affected only if the measure is *manifestly inappropriate* having regard to the objective which the competent institution intends to pursue […] (emphasis added)."

1501 Protocol (No 30), n. 599.

1502 Article 52 (Scope and interpretation of rights and principles) reads: "(1) Any limitation on the exercise of the rights and freedoms recognised by this Charter must be provided for by law and respect the essence of those rights and freedoms. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others. (2) Rights recognised by this Charter for which provision is made in the Treaties shall be exercised under the conditions and within the limits defined by those Treaties. (3). In so far as this Charter contains rights which correspond to rights guaranteed by the Convention for the Protection of Human Rights and Fundamental Freedoms, the meaning and scope of those rights shall be the same as those laid down by the said Convention. This provision shall not prevent Union law providing more extensive protection." See also J Schwarze, 'Der Grundrechtsschutz für Unternehmen in der Europäischen Grundrechtscharta', (2001) EuZW 517, 521.

1503 See Pache, n. 234, pp. 1035–6.

1504 This bears some resemblance to the German property right "doctrine" of *Sozialbindung*, see chapter 4 on Germany.

1505 ECJ, C-280/93, n. 241, no. 78. See also Joined Cases C-20/00 and C-64/00, n. 241, no. 68; C-265/87, n. 238, no. 15; C-5/88, n. 1124, no. 18; C-177/90 – *Kühn* v *Landwirtschaftskammer Weser/Ems*, (1992) ECR I-35, no. 16; C-22/94 – *The Irish Farmers' Association* v *Minister for Agriculture*, (1997) ECR I-1809, no. 27. The protection of "the very substance" of (economic) fundamental rights (see also ECJ, C-22/94 – *Irish Farmers Association*, *ibid*., no. 26, and C-491/01 – *The Queen/Secretary of State of Health*, [2002] ECR I-11453, no. 150), which is also referred to in Article 52 ECFR, is critically reviewed by von T von Danwitz, 'Eigentumsschutz

An application by the ECJ of the principle of proportionality to fundamental rights restrictions as a result of legislation, which is both nuanced and systematic, seems, however, not to have taken place so far.[1506] Such a deficit in the enforcement of fundamental rights protection can be inferred from the fact that the ECJ has so far never explicitly determined that EC legislation violated the right to property or any other (economic) fundamental right such as the freedom to choose and exercise an occupation or to pursue an economic activity.[1507]

The ECJ merely reviews restrictive legislative measures for manifest inappropriateness, and also with respect to the legitimacy of the objectives sought.[1508] Further, the review of the necessity of restrictive legislative measures is usually very brief and the ECJ regularly defers to the discretion of the

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in Europa und im Wirtschaftsvölkerrecht', in T von Danwitz, O Depenheuer, C Engel, *Bericht zur Lage des Eigentums*, 2002, pp. 215, 266, 281; P Huber, *Recht der Europäischen Integration*, 2nd ed., 2002, § 8 no. 71; S Heselhaus, 'Schutz von Unternehmen durch das Eigentumsrecht im Europäischen Gemeinschaftsrecht', in T Buha, C Nowak, H Petzold (eds), *Grundrechtsschutz für Unternehmen im europäischen Binnenmarkt*, 2004, pp. 97, 117 *et seq.*; Schmidt-Preuß, n. 241, p. 472. It may be recalled that the very substance of the economic fundamental right to property was also the core of the above discussions on Article 295 EC. In C-5/88 – *Wachauf*, *ibid.*, no. 19, the ECJ established that the very substance of the right to property is not interfered with and a regulation of the use of property is permitted if the owner receives a remuneration, which covers his costs and enables him to make some profit; in this respect, see also n. 1471 and accompanying text. Another important issue in the context of the right to property is the principle of the protection of legitimate expectations (*Vertrauensschutz*), which also seems to be part of the balancing test which forms part of the assessment of whether the right to property has been violated, see ECJ, C-295/03 P, n. 1476, no. 89. The protection of legitimate expectations in the context of the protection of the right to property finds its equivalent in the so-called continuation guarantee (*Kontinuitätsgewähr*) applied by the German BVerfG, see BVerfGE 101, 239, 257; 76, 220, 244 *et seq.*; 75, 78, 104; 71, 1, 11 *et seq.* See in greater detail, Schmidt-Preuß, n. 241, p. 473.

1506 Which differs from the application of the proportionality test to executive measures, see only the extensive discussions in this regard in re *Alrosa*, n. 242, analysed in Part 1 Chapter 2 on EC competition law enforcement. Some hints of balancing in the context of fundamental rights restrictions can be found in ECJ, C-84/95, n. 1466, nos 25 *et seq.*, C-274/99 P – *Connolly* v *Commission*, (2001) ECR I-1611, no. 48 (in the context of freedom of expression), and C-112/00 – *Schmidberger* v *Austria*, (2003) ECR I-5659, nos 80 *et seq.* (in the context of the free movement of goods). Only isolated violations of the proportionality principle including the principle of legitimate expectations (*Vertrauensschutz*), see *ibid.*, have so far been established, see in greater detail, Schmidt-Preuß, n. 241, p. 470. Although the *general* comparability of the fundamental rights protection at Community and national level was confirmed by the BVerfG in its seminal *Solange II* decision, BVerfGE 73, 339, 378 *et seq.*, 387 (see also BVerfGE 102, 147, 162 *et seq.*, and chapter 4 on Germany), there exists an apparent deficit in enforcement of fundamental rights protection in the EU, see only Schmidt-Preuß, n. 241, p. 470; Huber, n. 1505, § 8 no. 67; Pache, n. 234, p. 1035; Jarass, n. 1458, p. 1089.

1507 The latter rights are set out in Articles 15 and 16 ECFR and are discussed *infra*.

1508 See, for instance, ECJ, C-280/93, n. 241, no. 90; C-265/87, n. 238, nos 21, 22. It is true that in Germany, the legislature also possesses a margin of appreciation with respect to appropriate restrictions; this margin, however, seems to be reviewed more strictly and systematically, see only BVerfGE 50, 290, 341 – *Mitbestimmung*. See already chapter 4 on Germany.

legislature.[1509] An evaluation of alternative measures hardly ever happens.[1510] The actual balancing (or proportionality) of the right holder's interest and the burdens imposed by restrictive legislative measures as against the benefit for the general interest seems also not to be fully developed in the ECJ's case law if it takes place at all.[1511]

It can thus be said that judicial review of restrictions of fundamental rights in the area of economic activity in general and thus also with respect to the right to property is considerably underdeveloped in view of the density and depth of control of the legislature.[1512] Against the background of the need for an effective fundamental rights protection, it is therefore questionable whether it is right for the ECJ to impose the burden of proof on the party seeking protection both when reviewing the appropriateness and the necessity of a restrictive legislative measure.[1513] As regards the latter, i.e. where it is claimed that the existence of milder, less intrusive means are available to achieve the objective, the ECJ even goes as far as requiring the substantiation that the alternative measures proposed are practicable and consistent with the objectives to be achieved.[1514]

1509 See, for instance, ECJ, C-306/93 – *SMW Winzersekt GmbH* v *Rheinland-Pfalz*, (1994) ECR I-55555, no. 21; see also Schmidt-Preuß, n. 241, p. 470.

1510 Such as in ECJ, C-491/01, n. 1505, no. 139.

1511 See, for instance, ECJ, Joined Cases C-37/02 and C-38/02 – *Di Lenardo Adriano* v *Ministry of Foreign Trade and Commerce*, (2004) ECR I-6911, nos 84 *et seq*.; C-491/01, n. 1505, nos 122 *et seq*. Critically H-J Papier, 'Die Rezeption allgemeiner Rechtsgrundsätze aus den Rechtsordnungen der Mitgliedstaaten durch den Gerichtshof der Europäischen Gemeinschaften', (2007) EuGRZ 133, 134; Schmidt-Preuß, n. 241, p. 471; T von Danwitz, 'Der Grundsatz der Verhältnismäßigkeit im Gemeinschaftsrecht', (2003) EWS 393, 395, 399 *et seq*.; see, however, H-W Rengeling, P Szczekalla, *Grundrechte in der Europäischen Union*, 2004, nos 442 *et seq*., who seem to regard the application of the proportionality principle as comprehensive. Article 52(1) ECFR, which the ECJ has accepted as an interpretation tool, actually explicitly requires balancing to take place. See also D König, 'Der Schutz des Eigentums im Europäischen Recht', in Depenheuer (ed.), *Eigentum*, 2005, pp. 113, 128, and von Danwitz, *ibid*., p. 396, with respect to the indispensability of balancing where the conflicting interest, such as the right to property as opposed to effective competition, are weighed against each other. More generally, Schwarze, n. 1502. In this regard, the fair balance test as applied by the ECtHR, see chapters 5 and 6 on Great Britain and the Netherlands, serves as an example where the court undertakes a fully fledged means-ends analysis.

1512 Similar Jarass, n. 1458, p. 1094.

1513 See, for instance, ECJ, C-280/93, n. 241, no. 95; C-317/00 P(R) – *"Invest" Import und Export GmbH* v *Commission*, (2000) ECR I-9541, no. 61; contra von Danwitz, n. 1511, p. 396, and Schmidt-Preuß, n. 241, p. 470.

1514 See ECJ, C-317/00 P(R), *ibid*.; C-44/94 – *Queen* v *Minister of Agriculture*, (1995) ECR I-3115, no. 55; C-368/96, n. 1476, no. 79; C-295/03 P, n. 1476, no. 86.

e. Compensation

According to Article 17 ECFR, compensation must be paid if a deprivation of property takes place.[1515] Although the regulation of the use of property does not in principle entail the obligation to pay compensation, such regulation can, in exceptional circumstances require the payment of compensation in order to fulfil the requirements of the principle of proportionality because "in the absence of compensation, the restrictions on the right to property […] constitute a

[1515] The amount of compensation payable must be adequate but not necessarily amount to full market value. The adequacy of the amount of compensation payable can be inferred from ECtHR case law, see only *Papachelas* v *Greece*, no. 31423/96 (GC), ECHR 1999-II, no. 48, which was settled by granting just satisfaction on 4 April 2000: "The Court reiterates that an interference with peaceful enjoyment of possessions must strike a "fair balance" between the demands of the general interests of the community and the requirements of the protection of the individual's fundamental rights (see, among other authorities, the Sporrong and Lönnroth v. Sweden judgment of 23 September 1982, Series A no. 52, p. 26, § 69). Compensation terms under the relevant legislation are material to the assessment whether the contested measure respects the requisite fair balance and, notably, whether it does not impose a disproportionate burden on the applicant. In this connection, *the taking of property without payment of an amount reasonably related to its value will normally constitute a disproportionate interference that cannot be justified under Article 1* (of the First Protocol of the ECHR, which guarantees the right to property). *That Article does not, however, guarantee a right to full compensation in all circumstances, since legitimate objectives of "public interest" may call for less than reimbursement of the full market value* (see the Holy Monasteries v. Greece judgment of 9 December 1994, Series A no. 301-A, pp. 34–35, §§ 70–71) (emphasis and comments added)." According to *Lithgow*, n. 1179, nos 121, 125, compensation must be reasonably related to the value of the property, which normally equals its market value: "121. [T]he taking of property without payment of an amount reasonably related to its value would normally constitute a disproportionate interference which could not be considered justifiable under Article 1 [of the First Protocol of the ECHR]. Article 1 […] does not, however, guarantee a right to full compensation in all circumstances, since legitimate objectives of "public interest", such as pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value (see […] James and Others judgment, Series A no. 98, p. 36, para. 54). […] The valuation of major industrial enterprises for the purpose of nationalising a whole industry is in itself a far more complex operation than, for instance, the valuation of land compulsorily acquired and normally calls for specific legislation which can be applied across the board to all the undertakings involved. Accordingly, provided always that the […] fair balance is preserved, the standard of compensation required in a nationalisation case may be different from that required in regard to other takings of property. […]. 125. Parliament decided to base compensation on the *value of the shares* in the nationalised companies. […] The principal alternative would have been to base compensation on the value of the underlying assets […]. […] [V]aluing a business which is to continue to operate as a going concern earnings may often be a more important factor than assets (emphasis and comments added)."

disproportionate and intolerable interference."[1516] This is normally the case for *de facto* expropriations.[1517]

Should compensation be payable, the question is whether the European Union as initiator of restrictive legislative measures is liable for its payment or the Member States, which, where such measures are prescribed in Directives, have to implement them. EC Directives normally leave some leeway to the Member States as to how to achieve the objectives of such legislation. Depending on the choice the Member States make, e.g. in the case of the Commission's proposals (of 19 September 2007) for third generation Energy Directives whose objective it is to achieve complete independence of energy transmission networks from vertically integrated energy supply undertakings, Member States would have the choice between ownership unbundling or the introduction of ("deep") ISOs (with powers to invite tenders for investment).[1518] Consequently, either expropriation[1519] or mere regulation of ownership could be the result, the first of which would definitely require compensation to be paid and the latter would be likely to require compensation (see in greater detail below). Thus, if all options available in a Directive entailed the obligation to pay compensation, i.e. without other implementation options[1520] not requiring compensation, adequate compensation mechanisms would have do be provided by the European Union.[1521]

1516 ECJ, Joined Cases C-20/00 and C-64/00, n. 241, no. 79, states: "As to whether, taking into account the objective sought and *in the absence of compensation, the restrictions on the right to property resulting from those measures constitute a disproportionate and intolerable interference* impairing the very substance of the right to property, it must be observed that those measures are urgent and are intended to guarantee that effective action is implemented […] (emphasis added)." See also ECJ, C-347/03 – *Tocai*, (2005) ECR I-3820, nos 122 *et seq*.

1517 Jarass, n. 1458, p. 1095; this also bears similarities to the fair balance test as applied by the ECtHR, see chapters 5 and 6 on Great Britain and the Netherlands, and to the German *Inhalts- und Schrankenbestimmung*, which in exceptional circumstances also carries the obligation to pay compensation, see the seminal decisions of the BVerfG in BVerfGE 58, 137, 147 *et seq.*, and BVerfGE 100, 226, 241 *et seq.* – *Denkmalschutz* on the kind of regulation of ownership requiring compensation. See further Schmidt-Preuß, n. 241, p. 473. Such regulation only entails the obligation to provide for compensation if the effect of the interference with the right to property is similar to a complete deprivation of property, which in turn can be regarded as the German equivalent to *de facto* expropriation under ECHR and EC law. See also chapter 4 on Germany.

1518 See Introduction.

1519 By way of forced sale. In greater detail and based on ECtHR case law, see the Introduction and chapter 6 on the Netherlands as regards both the fact that forced sale amounts to expropriation and the fact that even if there is the option to transfer either competitive energy supply or energy supply network (operation) activities, an expropriation would still take place.

1520 Such as, in the context of the Directives at issue, the third option agreed on 9 October 2008 by the EC Council of Energy Ministers to be included in the upcoming third generation Energy Directives, see Introduction and chapter 4 on Germany.

1521 I.e. on the assumption that the prescription of ownership unbundling and/or the introduction of "deep" independent system operation would only become proportionate if adequate compensation (not necessarily amounting to full market value) was paid, which would mean that the EU could exercise its competence to impose these measures, which includes the EU's

If the national legislation implementing Directives of that kind are enforced, the EU would also be liable to pay compensation.[1522] On the assumption that at least one of the options set out in a Directive carrying the obligation to pay compensation is otherwise legitimate[1523], this is so because, first, the principal decision of a Directive is mandatory for Member States to follow, which in the case of the Energy Directives at issue is that control of the energy networks must be independent and thus be surrendered by the vertically integrated energy supply undertakings, and thus the effects of enforcement are causally linked to the EU.[1524] Secondly, there is no alternative not requiring compensation. Thirdly, the effect of such a Directive would be similar to a directly applicable and enforceable Regulation, of which the effects are, again, always causally linked to the EU: the Directives (and thus an action by the EU) would be the cause of the otherwise legitimate expropriation or regulation of ownership, which do not leave Member States the choice of implementing an option which would not be liable to trigger compensation.

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compliance with Article 56 EC, and on the further assumption that the Member States opting for these measures would not be breaching their respective constitutional laws. Under EC law, provision for compensation does not have to be contained in the same law which requires the deprivation of property. Further, the ECJ has regarded it sufficient that the administration can award compensation as it sees fit, i.e. that it possesses a degree of discretion, see ECJ, C-5/88 – *Wachauf*, n. 1505, no. 22, C-2/92 – *Queen v Ministry of Agriculture*, n. 1468, no. 14. As Directives are implemented by the Member States, the national law obviously also has to contain compensation provisions; however, the principal liability for comepnsaion belongs to the EU, see also the elaborations, which follow.

1522 Similar Schmidt-Preuß, n. 241, p. 473; *cf.* Storr, n. 512; as regards the amount of compensation, see n. 1515. Compensation payable by the EU would be residual in nature: the state or private parties to whom assets are transferred in the course of (*de facto*) expropriation would have to pay *adequate* compensation (not necessarily the market value), see chapter 5 on Great Britain. As the transfer is happening in the context of a forced sale, the purchaser is normally not predetermined, which means that negotiations about the purchase price would have to be conducted. The market for energy supply network assets is, however, likely to be a purchasers' market, i.e. there is not a sufficient number of potential buyers in the market and/or assets have to be sold by a specified time in the future, which puts potential buyers in a stronger bargaining position than the seller. Thus, adequate compensation may not be obtainable, either because of differences in valuation and/or because (potential) purchasers do not want to pay an adequate purchase price; consequently, either the State would have to take over the assets in question *or* would have to approve of the sale for less than the adequate price and pay the adequate price if the first scenario applied or the shortfall below the adequate price if the second scenario applied.

1523 And could become proportionate if adequate compensation was paid.

1524 As regards the distinction between mandatory principal objectives and the range of tools available for Member States to achieve these objectives, see also F Schorkopf, 'Eigentumsrechtliche Entflechtung aus verfassungs- und europarechtlicher Sicht', in W. Löwer (ed.), *Neue rechtliche Herausforderungen für den Strommarkt*, Bonner Gespräch zum Energierecht, Band 3, 2008, pp. 117 *et seq.*, 119, 120; see further the chapter 4 on Germany as regards the question of what situation EC fundamental rights are solely applicable and where national fundamental rights standards are also (or only) applicable.

Moreover, even if the least intrusive option is chosen by one Member State, which might in principle entail less compensation payable, full compensation would have to be provided by the EU if legislation gave rise to consequences, which had an expropriatory effect entailing full compensation. For example, this could be the case for the current draft of the Energy Directives because as has already been outlined in Part 1 Chapter 3 on Article 56 EC, they (although to a lesser extent than the Commission's proposals of September 2007) suggest that "companies engaged in the production or supply of gas or electricity [should be prohibited] from exercising control over a transmission network operator of a Member State that has opted for full unbundling."[1525] This would mean that energy generation or production and supply undertakings (i.e. exclusive of TSOs) whether vertically integrated or not, would either have to give up their (shareholdings in) energy transmission networks (including any network operations) in Member States which have opted for ownership unbundling or not be allowed to acquire such interests or control. Similar to ownership unbundling, this would mean that existing transmission network (operation) activities would have to be sold or that such generation/production and supply undertakings would be prevented from establishing an economic activity in the area of transmission networks in Member States which have opted for ownership unbundling. Such a prescription in (EC) legislation amounts to a forced sale, which, as has already been shown, amounts to a deprivation of property, which in turn requires adequate compensation to be paid.

2. FREEDOM OF ECONOMIC ACTIVITY

Unlike the ECHR, EC law includes the fundamental right of the freedom to pursue an economic activity ("trade or business") and the freedom to choose and pursue an occupation.[1526] Not only has the ECJ long recognized these freedoms

[1525] See Council of the European Union, nn. 372 *et seq.* and accompanying text, also with regard to the approval by the European Parliament in April 2009 and the Commission's proposals of September 2007. According to the draft Electricity and Gas Directives as agreed by the Council such undertakings are also not allowed to own transmission networks in such Member States. The agreed proposals do not refer to vertically integrated companies in this context any more as opposed to the more far reaching intentions expressed by the Commission in its original proposals, n. 15. Thus, vertically integrated TSOs (not vertically integrated generation/production and supply undertakings!) in Member States which opt for the ISO alternative or the 3rd way (see Introduction for more details) seem to be able to control TSOs or own transmission networks in Member States which have opted for ownership unbundling.

[1526] As to the boundaries between these two fundamental rights, see Blanke in Tettinger/Stern, *Kölner Gemeinschaftskommentar zur Europäischen Grundrechte-Charta*, 2006, Article 16, nos 3, 20. The ECtHR has, however, applied the right to property broadly so as to include some aspects of these rights as well, see chapters 5 and 6 on Great Britain and the Netherlands.

as being general principles of Community law[1527], but they are also explicitly set out in the ECFR.[1528]

As has already been outline above, the right to property protects what has been acquired or acquired rights, i.e. the substance of the property owned, whereas the freedoms at issue here protect the (process of) acquisition or the action of economic activity.[1529] When applying both, the ECJ usually does not make this distinction.[1530] The Court also considers (as in the case of the right to property) the right to conduct business not as absolute but in relation to its social function.[1531] The assessment by the ECJ of an interference with the right to property and the freedom to pursue an economic activity and its proportionality follows exactly the same patterns.[1532] Thus, as the right to property is the main economic fundamental right interfered with by further unbundling measures, the freedom to pursue an economic activity is not further discussed here. All relevant issues in the context of this freedom have already been discussed in the previous chapters and are similarly valid here.

3. GENERAL PRINCIPLE OF EQUALITY

As has already been outlined above, Article 295 EC reflects the neutrality of the EC Treaty as regards property ownership and thus leaves the decision as to whether economic undertakings should be private (privatized) or in public ownership (nationalization) to the Member States. It has also already been established that the mere regulation of ownership, which does not result in a *de facto* expropriation or does not have the effect of an expropriation, can in principle be imposed by European legislation; accordingly, the imposition of independent system operation or unbundling which does not go so far as to require (*de facto*)

1527 ECJ, C-4/73, n. 536, nos 12–14; C-44/79, n. 536; C-234/85 – *Keller* v *Staatsanwaltschaft Freiburg*, (1986) ECR 2897, no. 8.

1528 Article 15(1) ECFR (Freedom to choose an occupation and right to engage in work) states: "Everyone has the right to engage in work and to pursue a freely chosen or accepted occupation." Article 16 ECFR (Freedom to conduct a business) states: "The freedom to conduct a business in accordance with Union law and national laws and practices is recognised." The EC fundamental freedoms of the right of establishment and the free movements of persons, goods and services (and capital) are expressions of these fundamental freedoms.

1529 When both aspects are affected, both fundamental rights are applied in parallel (*Idealkonkurrenz*). See in greater detail, chapter 4 on Germany, also as regards the applicability of these freedoms in the context given.

1530 See only ECJ, Joined Cases C-248/95 and C-249/95, n. 1476, nos 72–75; C-200/96, n. 1479, nos 21 *et seq.*; C-317/00 P(R), n. 1513, no. 58.

1531 See, e.g., ECJ, C-280/93, n. 241.

1532 See, e.g., ECJ, C-104/97 P, *Atlanta v Council & Commission*, (1999) ECR I-6983, no. 12; C-265/87, n. 238, no. 15.

expropriation is likely to be in compliance with Article 295 EC. This has however confronted the Commission with an insurmountable dilemma as regards its plans to impose ownership unbundling of energy transmission networks because publicly owned vertically integrated energy supply undertakings owning and operating energy transmission networks could not be forced to sell their networks to private undertakings. The proposals of the Commission of 19 September 2007 and the draft Energy Directives as agreed by the European Council in October 2008 (and approved by the European Parliament on 22 April 2009) thus used a "trick" and simply classified the provision for the transfer of networks owned by publicly owned energy supply undertakings to other public law entities or organizationally separate state units or divisions as ownership unbundling.[1533]

The view of the Commission and the Council that such structural separation can be classified as ownership unbundling, is flawed, however, because the competitive energy supply activities on the one hand, and the energy supply network activities on the other would continue to be owned and operated by the State as one and the same person, no matter whether both activities are "integrated" in one organizational unit or separate in two units. This is so because different organizational layers, units or subdivisions of a State are perceived as one entity under EC law, no matter whether they are state authorities or undertakings.[1534]

1533 The *Explanatory Memorandum* of the Commission's proposals of 19 September 2007, n. 15, state on p. 6: "In keeping with Article 295 EC, the proposal applies in the same way to publicly and privately owned companies. This means that irrespective of its public or private nature, no person or group of persons would be able alone or jointly to influence the composition of the boards, the voting or decision making of both transmission system operators or the supply or production companies. This ensures that where supply or production activities are *in public ownership*, the independence of a publicly owned transmission system operator is still guaranteed; but these proposals do not require state owned companies to sell their network to a privately owned company. For instance, to comply with this requirement, any public entity or the State could transfer the rights (which provide the "influence") to another publicly or privately owned legal person. The important thing is that in all cases where unbundling is carried out, the Member State in question must demonstrate that in practice, the results are truly effective and that the companies operate entirely separate from one another, providing a real level-playing field across the whole of the EU. It is on that basis that the Commission will assess whether in individual cases the distinct public bodies fulfill the unbundling requirements set out in this Directive [emphasis added]." Article 9(6) of the draft Electricity and Gas Directives of 22 April 2009 (finally adopted unamended by the Council of the European Union on 25 June 2009), n. 33, which deals with ownership unbundling, states: "For the implementation of this Article, where the person referred to in paragraphs 1(b), 1(c) and 1(d) is the Member State or another public body, two separate public bodies exercising control, on the one hand, over a transmission system operator or over a transmission system and, on the other hand, over an undertaking performing any of the functions of production or supply, are deemed not to be the same person or the same persons."

1534 Kahl in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 10, no. 18. The only exception might be municipalities in a federal state such as Germany because (similar to national company law), national constitutional law such as Article 28(2) GG confers a particular status (institutional guarantee) on such (public law) entities. In this respect, EC law might recognize

Because private and public undertakings are treated differently, the general principle of equality might be violated. The general principle of equality belongs to the common constitutional traditions of the Member States and to the general principles of Community law as recognized by the ECJ, according to which "similar situations shall not be treated differently unless differentiation is objectively justified".[1535] Further, the general principle of equality is also set out in Article 20 ECFR, which applies both to equal treatment by the legislature and the executive.[1536]

For there to be a violation of the general principle of equality, there must be a difference in treatment of comparable situations, which is not justified. The situations to be compared must at least in essence be similar.[1537] In the context of the draft Energy Directives at issue here, there are no reasons why private and public energy supply undertakings should not be comparable.[1538] The further unbundling measures are, according to the Commission's opinion[1539], only effective if all energy supply undertakings have to surrender control of their energy transmission networks. Thus, the rationale for the draft legislation concerns both private and public energy supply undertakings. Both types of undertakings pursue network and competitive energy supply activities and compete with each other. Further, the EU's neutrality towards the national property orders according to Article 295 EC and the equal treatment of undertakings active in rendering services of general economic interest according

institutional distinctions made in federal states in a way similar to its recognition of the national company law "decision" that an undertaking is a legal person. Consequently, following the view taken in this work that public undertakings are also eligible to claim fundamental rights protection in the specific context of energy supply, requiring municipalities or vertically integrated energy supply undertakings in which they participate to transfer their networks or remaining energy supply activities might amount to ownership unbundling. As currently "only" energy transmission networks are subject of the new Energy Directives, "only" undertakings such as RWE and EnBW of Germany would be concerned; as regards energy distribution networks, see n. 1540 *infra*.

1535 Rossi in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 20 GrCh, no. 2; see also, for instance, ECJ, Joined Cases C-117/76 and 16/77 – *Ruckdeschel & Ströh* v *Hauptzollamt Hamburg St.-Annen* and *Diamalt AG* v *Hauptzollamt Itzehoe*, (1977) ECR 1753, no. 7.

1536 Calliess, n. 509, p. 95; Callliess, 'Article 6', in Calliess/ Ruffert, *EUV/EGV*, 3rd ed., 2007, no. 22. As regards the entities entitled to rely on the general principle of equality, the discussion in the context of the right to property is applicable here.

1537 See Calliess, *ibid.*, (2007) et 92, 96, with further references.

1538 The judgment of the ECJ, Joined Cases C-188/80 and C-190/80 – *France, Italy & United Kingdom* v *Commission*, (1982) ECR 2545, no. 21, cannot be regarded as indicating a lack of comparability because in this judgment state internal issues were at stake whereas here, market entry is an issue outside the state sphere, see Calliess, n. 1536, (2007) et 92, 96.

1539 See n. 10, p. 13.

to Articles 16, 86(2) EC, no matter whether they are public or private, are further indications that public and private undertakings are comparable.[1540]

Unequal treatment results from the fact that the proposed Energy Directives only force private undertakings, and not also public energy supply undertakings, to surrender their control over energy transmission networks.[1541] Further, the disadvantage resulting from unequal treatment[1542] is reflected in the fact that only the State will in the future be allowed to own and operate energy supply networks together with competitive energy supply activities in one person[1543] whereas private energy supply undertakings do not have this opportunity any more and can thus no longer earn network charges.[1544]

It is questionable whether this detrimental unequal treatment can be objectively justified. Article 295 can not serve as justification because it would contradict the neutrality of the EC law towards the national property orders that this provision is supposed to embody.[1545] Further, the assumption that public undertakings would treat all (potential) market participants as equal is also not valid. EC provisions such as Article 86 EC would otherwise not make sense.[1546]

In conclusion, it can be said that the general principle of equality coupled with Article 295 EC requires that the EC legislature can only order further unbundling, which treats private and public undertakings as equal.

1540 See also Calliess, n. 1536, (2007) and 92, 96, according to whom the situation in the area of energy distribution networks appears to be similar, with some peculiarities with respect to German municipal energy supply undertakings, see already n. 1534.

1541 Forcing public energy supply undertakings (for the definition, see n. 1488) to surrender to privately controlled energy supply undertakings (for the definition of substantive privatizations, see chapter 6 on the Netherlands) would be in breach of Article 295 EC as understood here; as regards focing private undertakings to surrender is in itself, i.e. apart form the issue discussed here, in breach of Article 295 as understood here, see Part 1 Chapter 3.

1542 Required by the ECJ, Joined Cases C-17/91 and C-20/61 – *Klöckner-Werke and Hoesch* v *High Authority of the European Coal and Steel Community*, (1962) ECR 325, 345.

1543 The unbundling requirement in the draft Directives is thus only functional or organizational in nature. In the Netherlands, for instance, GTS is the state-owned gas transport incumbent and Gas Terra, the incumbent gas supply undertaking, is jointly owned amd controlled by the Dutch State (50%) and Shell and Exxon Mobile (50%). See already chapter 6 on the Netherlands, in particular n. 1272.

1544 Assuming that the operation of the networks can be pursued profitably, such network charges are likely to be higher than the profits resulting from the capital interest earned from the purchase price received for the forced sale of the networks, see Calliess, n. 1536, (2007) and 92, 97.

1545 See in greater detail, Calliess, n. 1536, (2007) and 92, 97.

1546 French state owned EDF whose abusive behaviour has been ruled on several times by French courts and the European Commission, serves as example that such an argument is indeed invalid as does the determination that French state controlled electricity networks do no necessarily enable non-discriminatory market access, see Calliess, n. 1536, (2007) and 92, 97, for further details.

III. APPLICATION TO FURTHER UNBUNDLING MEASURES

The further unbundling measures assessed here, i.e. ownership unbundling and independent system operation as proposed by the Commission on 19 September 2007, are supposed to ensure the independence of energy transmission network operations from the remaining energy supply activities.[1547]

The objectives the independence of energy transmission networks are supposed to achieve are extensively discussed in Part 1 of this work and are in principle legitimate. Further, it may be recalled that Article 95 has been accepted as sufficient legal basis for further unbundling measures. However, it has also been established that the exercise of this competence with respect to the introduction of ownership unbundling is prohibited and that the prohibition on certain vertically integrated energy supply undertakings of one Member State owning and operating energy transmission networks in Member States which have implemented ownership unbundling violates Article 56 EC. Further, it has been concluded that the introduction of further unbundling from a competence point of view is contrary to the subsidiarity principle and disproportionate. Thus, the points which follow are made for the sake of completeness and as an essential basis for the comparative conclusions to follow.

1. OWNERSHIP UNBUNDLING

Outright ownership unbundling as well as its seemingly milder version, the so-called share split, are deprivations of property of the vertically integrated energy supply undertakings under EC law.[1548]

Further, the draft Energy Directives prohibit (although to a lesser extent than the Commission's proposals of September 2007) "companies engaged in the production or supply of gas or electricity […] from exercising control over a

[1547] The so-called "Third Way" or "Effective and Efficient Unbundling" as third option contained in the proposals for Energy Directives as agreed by the European Council in October 2008 are not discussed further here. In this regard, see Introduction and chapter 4 on Germany. Similar to the analysis there, this option can also be qualified as "mere" (proportionate) regulation of the right to property under EC law, for which the EU possess an enforceable competence. In the draft Directives as agreed by the European Council in October 2008, this option is called ITO (Independent Transmission Operator), see Recital 12, Articles 9(8), 17 *et seq.* (chapter V) of the draft Electricity and Gas Directives.

[1548] The discussion of the different scenarios and options in relation to fulfilling the ownership unbundling requirements in the chapters 4 and 5 on Germany and Great Britain also apply here.

transmission network operator of a Member State that has opted for full unbundling."[1549] As has already been explained, this would mean that energy supply undertakings (i.e. exclusive of TSOs) whether vertically integrated or not, would either have to give up their (shareholdings in) energy transmission networks (including any network operations) in Member States, which have opted for ownership unbundling or not be allowed to acquire such interests or control. Similar to ownership unbundling, this would mean that existing transmission network (operation) activities would have to be sold or that such energy supply undertakings would be prevented from establishing an economic activity in the area of transmission networks in Member States, which have opted for ownership unbundling. Such a legislative prescription would amount to a forced sale, which, as has already been shown, is a deprivation of property, initiated by EC law.

As has been established in the discussion in the chapter on Germany with respect to the interference with the freedom to pursue an economic activity, and given the fact that under EC fundamental rights protection as applied by the ECJ, which assesses both the right to property and the freedom to pursue an economic activity in the same manner when both rights are at stake, the freedom to pursue an economic activity is also interfered with.

2. "DEEP" INDEPENDENT SYSTEM OPERATION

The Commission's alternative proposal of introducing Independent System Operators (ISO) with powers to take investment decisions and to invite tenders for investment[1550] would result in the creation of an ISO, which became solely responsible for investment planning and decisions, requiring the approval of national regulatory agencies' (NRA).[1551] If the energy transmission network owners were not prepared to make the investment ordered by the ISO themselves, the ISO could then invite tenders for such investment in the market on its own initiative and under its own authority. The owners would be "downgraded" to mere service providers maintaining and rendering technical services for their own grids (in particular in the context of investment put out to tender) or investors in their own grids. They would not only not be able to decide about investments

1549 See nn. 33, 372, 466 and accompanying text.

1550 The points which follow are similar to those in the chapter 5 on Great Britain, For the idea behind introducing "deep" ISO and the problem of strategic investment withholding, see also in that chapter.

1551 See Article 10(5) and (6) of the Electricity Directive as proposed by the Commission, n. 15, and Article 13(5) and (6) of the draft Electricity and Gas Directives, n. 33.

in their own grids and they would also be compelled to accept investments by third parties in their grids.[1552]

Thus, further unbundling in the form of forcing network owners to also surrender their investment decision (and tendering) powers over their networks to an ISO should also be classified as a deprivation of property in the form of a *de facto* expropriation of network property, rather than a deprivation of the right to use, control, let or sell (regulation of ownership). All property competences[1553] would have to be transferred to the ISO, which results in leaving the legal right to network ownership as an "empty shell" (with only the formal right to sell the property remaining). One of the most important competences of legal ownership is taken away, i.e. the decision to deal with one's property freely, which includes the competence to use or not to use one's property as one pleases. The owner is left with the mere physical property without being able any longer to decide about its use or non use or to decide whether to permit certain uses and users any more.

For the vertically integrated energy supply undertakings, which own the networks, there would no sensible alternative use of the network property be left; sensible use of the networks can only be made by those who actually dispose of

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1552 The Commission proposals, n. 15, and the draft Energy Directives, n. 33, do not contain any indications of whether investments required by the ISO have to be economic let alone profitable, an omission, which might lead to overinvestment, see The Brattle Group, n. 191. See The Brattle Group, n. 1194, p. 71, defining "economic" investments as investments to reduce the costs of persistent congestion. Although investment decisions and invitations to tendering for investment are subject to approval of the national regulatory agency, the criteria for such approvals are not known, at least with respect to whether investments have to be economic or profitable. The only time efficient and economic investment is mentioned (and only in the draft Energy Directives) is where the drafts set out as one of the tasks of the regulator in Article 36(3)(d) to "ensure that network access tariffs collected by independent system operators include a remuneration for the network owner or network owners that provides for an *adequate* remuneration of the network assets and of any new investments therein, *provided they are economically and efficiently incurred* [emphasis added]". It is unclear, however, whether the network owner has to "suffer" for uneconomic investment decided and approved by the ISO and the regulator, respectively, or what else is meant by this provision, see further n. 1554. It only becomes clear that the regulator checks and approves the investment decisions or tendering processes conducted by the ISO, see Article 10(5) and (6)(b) proposed Electricity Directive, Article 13(4) and (5)(b) draft Directives, against the non-binding European-wide 10-year network development plan, Article36(1)(f) draft Directives, and the multi-annual network development plan presented on a yearly basis by the independent system operator, Article 36(3)(c) draft Directives. All of this does not, however, necessarily protect the network owners against uneconomic or unprofitable investments. A network owner would only be able to refuse to invest himself, which would lead to a tendering process for such investment, which in turn would result in the "downgrading" to a mere service provider as explained in the main text.

1553 See Introduction.

the networks (which includes operation and investment decision powers). The current network owners would lose every aspect of their ability to deal with the networks as their (apart, obviously, from selling them) and in particular the ability to decide (at least jointly with others) about network investment. The TSO can order the network owners to do whatever it needs to operate the grid including the maintenance of "their" grid. The network owners are downgraded to mere and exchangeable providers of service on their own grids, which does not give them any economically beneficial use of their property but only out of their economic activity as service provider.

The loss of use and control of the networks are the decisive factors for the determination of the value of the network property. The right to use property for one's own purposes, which is *the* fundamental function of property (apart from serving the general interest (social function)), would be converted to a right to receive a mere monetary consideration in return for putting property at the disposal of the ISO, which in any event is determined by the regulator. This regulated nature of the return further contributes to the almost complete devaluation of the network assets.[1554]

In the current context, there would not even be a fair conversion to a mere monetary consideration, which might in itself (if fair) be considered to be a sufficient compensation for the loss of the right to (a sensible alternative) use the networks. There would also be a deprivation of the last major right, i.e. to the right to decide what to do with one's property, or what *not* to do. This "negative" competence forms part of the right to property and in this context means the "negative" freedom *not* to invest.

The preservation of the value of the network property, which could be considered to be a sensible alternative use of such property, is also not applicable here. This is

[1554] The uncertainty as to under which circumstances the network owner receives an adequate compensation, see n. 1552, must in principle be resolved by the EC legislator according to the principle that interferences with fundamental rights require a sufficient legal basis. This principle can be inferred from Article 52 ECFR and seems to have been accepted by the ECJ, for instance in re *Booker Aquaculture*, n. 241, no. 64 (with respect to compensation) and in re *Flughafen Hannover-Langenhagen I*, n. 512, no. 56 (with respect to the quality of provisions of a Directive, which require fees for *infra*structure access to be determined "according to relevant, objective, transparent and non-discriminatory criteria"), see also ECJ, C-46/87 – *Hoechst* v Commission, (1989) ECR 2859, no. 19. The determination of the details of adequate compensation and the circumstances under which such compensation is payable, on the other hand, have to be left to the Member States because they depend on the choice made by the Member States and their respective legal systems. Jarass, n. 928, § 6 nos 36 *et seq.*, and § 22 nos 27 *et seq.*, and Kingreen in Calliess/Ruffert, *EUV/EGV*, 3rd ed., 2007, Article 52 EU-GrCh, seem to assume that it is not sufficiently clear yet whether an interference initiated by the EU requires a legal basis in EC law or whether it suffices that Member States' legislation provides for such a legal basis.

because assuming that the book value of the network assets remained on the balance sheet of the legal network owners, their trading value is lost for the reasons set out above; if, for accountancy reasons, the assets appeared in the balance sheet of the ISO, this would be a further indication that the introduction of this further unbundling measure should be considered a deprivation as opposed to a regulation of property.

3. MARGIN OF APPRECIATION AND PROPORTIONALITY

As outlined above, the legislative measures of ownership unbundling and "deep" independent system operation have to pass the proportionality test as outline above. The objectives to be achieved[1555] are within the margin of appreciation of the EC legislature, i.e. not manifestly unreasonable, and thus in principle legitimate.

Both legislative measures would, however, disproportionately interfere with the network owners right to property as well as with the freedom to pursue an economic activity as protected by the European Union.[1556]

For ownership unbundling, this can be inferred from the analogous application of the proportionality test in the competition law enforcement context as set out in Part 1 Chapter 2[1557]; the arguments used in the chapter on Germany in the

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1555 Further unbundling of energy supply undertakings aims at safeguarding the structural independence of the network operations and related thereto increasing the transparency of the energy markets, which is considered to contribute to the achievement of the establishment and promotion of an internal market for energy supply (greater market integration), the promotion and protection of competition in energy supply throughout the EU and the safeguarding of supply security and reliability; in order to achieve all these aims, and to achieve them for the benefit of the consumer, sufficient investment in energy transmission and interconnection network capacity is considered a *sine qua non* condition by the European Commission. See in greater detail the chapter 5 on Great Britain and Part 1 Chapter 1.

1556 As regards the role a social cost and benefit analysis should play in the context of the proportionality test and which outcome is required to justify further unbundling measures such as ownership unbundling and "deep" independent system operation, see chapter 5 on Great Britain and Part 1 Chapter 2.

1557 The corresponding evaluations there also apply here analogously, see Part 1 Chapter 2. The structure of the proportionality test applied in the context of fundamental rights protection follows or is similar to the structure of the proportionality tests as applied in a competition law enforcement context, and in the context of the ECHR and German constitutional law. EC competition law is enforced by the Commission as part of its executive function and thus the margin of appreciation is narrower, see Part 1 Chapter 2. The (wider) margin of appreciation of the (EC) legislature as regards the objectives sought with further unbundling measures is not disputed here.

context of the compliance of ownership unbundling with the German constitution are also applicable here.

As regards the envisaged introduction of "deep" independent system operation, its disproportionality has already been set out in the chapters on Great Britain and Germany.[1558] On the other hand, the introduction of an ISO model along the lines of what is currently in place in Scotland can be regarded as proportionate as long as sufficient judicial protection is available against (final) decisions of regulatory agencies and as long as ISOs do not have direct investment (tendering) decision powers as against the network owners.[1559]

IV. CONCLUSIONS

It has been established in this chapter that in theory the fundamental rights protection in the EU in general, and against legislative measures introducing further unbundling measures in particular, which includes the test of the proportionality of these legislative measures, is similar in structure and content to the protection given by the ECHR and German constitutional law. However, in practice, the level of protection in the area of economic fundamental rights protection is almost non-existent, in particular when it comes to applying the proportionality test. This is the more surprising because Article 53 ECFR, which has been recognized by the ECJ as an interpretation tool, provides that fundamental rights protection in the EU is not a "race to the bottom" but respects the "human rights and fundamental freedoms as recognised […] by the Member States' constitutions."

It has further been explained that public undertakings as defined by EC law are likely to enjoy fundamental rights protection in the EU. Differentiating between

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1558 The elaborations made there are also applicable here. The arguments used in the British context are of particular relevance as the Commission regards the UK as a shining example of successful energy supply industry unbundling and liberalization, see Part 1 Chapter 2. As regards the special social function of network property as a justification for more far-reaching restrictions of the EC fundamental rights at issue here and thus the particular balancing and weighing undertaken in relation thereto, see the chapter 4 on Germany in the context of the justification of TPA; the discussions made there are analogously applicable here.

1559 It is important to note that private parties such as privately held ISOs cannot, other than on the basis of private law contracts, oblige other private parties such as privately held network owners to act in a certain way. It may be recalled that the introduction of an ISO model as briefly set out in the main text and in the chapter 4 on Germany is the furthest extent to which the competence of the EU can be exercised according to the results presented in this work, see Part 1 Chapter 3. One of the reasons is that Article 295 EC as interpreted here only allows the EU to regulate ownership but not to expropriate; the introduction of "deep" ISOs would lead to a *de facto* expropriation as has just been established.

private and public undertakings to the extent that the first have to give up ownership of their networks whereas the latter can simply shift them within the state organization, infringes the general principle of equality as protected by EC law. Further, if the EC legislature passes legislation, which contains measures, all of which carry the obligation to provide for compensation, it has been established that the EU indeed is liable for its payment.

Coming to the question of whether further unbundling complies with EC fundamental rights protection, it has been established that ownership unbundling would indeed be unlawful. The introduction of ISOs, on the other hand, might not be, as long as they are not "deep". Where they are "deep", much will depend on the level of compensation granted.

CONCLUSIONS
DRAWING (COMPARATIVE) LESSONS

This work has analyzed the legitimacy of energy supply network unbundling measures (exceeding the current legal unbundling requirements) as threatened or proposed by the European Commission on the basis of European economic regulation competences.

Apart from threatening to order the divestiture of energy networks of individual vertically integrated energy supply undertakings, the Commission originally proposed to either impose energy transmission network ownership unbundling (OU) or "deep" independent system operation ("deep" ISO), which would give independent energy transmission system operators exclusive investment decision and commissioning (tendering) powers. In addition, the current draft Electricity and Gas Directives contain as a third option the implementation of independent transmission operators (ITOs).

This third option has not been the subject of the analysis as to what extent the further legislative unbundling measures (OU and "deep" ISO) – if introduced in isolation – would be in breach of economic fundamental rights, in particular the right to property, as protected in Germany, Great Britain, the Netherlands and the European Union. Introduced in isolation means without including further options with a lesser impact on fundamental rights such as the ITO option, which is merely a stricter form of legal unbundling and as a mere regulation, or deprivation of one part, of the right to property is still in compliance with the fundamental right to property.

A. EC COMPETENCES IN COMPETITION LAW AND SECTOR REGULATION

The Commission's threat to order the divestiture of individual vertically integrated energy supply networks by using its competition law enforcement powers is based on the results of a sector inquiry, which analysed the data and the case presented by the industry as they stood at the end of 2005.

The view has been taken here, however, that such a competition law based measure would not only be *ultima ratio* but actually disproportionate to the objective sought, which is to restore competition in an internal energy supply market. One main basis for this view is the results of economic analysis, which raises serious doubts about the analysis and case studies used by the Commission to support its case.

A recently conducted social cost benefit analysis, which is equally applicable in the context of the proportionality of competition law based measures and further unbundling measures introduced by legislation, shows that legal ownership unbundling or divestiture and "deep" independent system operation of energy supply networks would, if at all, only be of marginal benefit to consumer welfare. For electricity, the benefit largely depends on the existence of sufficient generation. With respect to gas, it has been shown that regulation in tandem with competition law enforcement suffices. Further, as energy transmission network ownership unbundling does not necessarily require less regulation, the cost of regulating vertically integrated energy supply networks would not be significantly higher than the cost of regulating completely separate network businesses.

Should divestiture nevertheless be ordered by the Commission the European courts would apply a test of proportionality to such an executive measure which is stricter than the test they would apply in the course of reviewing the compliance of EC legislation introducing further unbundling measures with fundamental rights as protected on EU level.

With regard to EC legislation as second leg of EC economic regulation, assuming that it was in principle legitimately based on the harmonization competence of Article 95 EC to introduce further unbundling measures as originally proposed by the Commission, the EC legislature would in fact not be allowed to exercise this competence for several reasons.

The primary reason is that it would be in breach of Article 295 EC and be likely to violate the EC fundamental freedom of free movement of capital as guaranteed by Article 56 EC. There would be a breach of Article 295 EC because the EU is not competent to legislate in the area of property ownership allocation, which ownership unbundling and "deep" independent system operation as (*de facto*) expropriation would belong to. Article 56 EC or the fundamental freedom of the free movement of capital would be compromised because the current draft Directives in prohibiting vertically integrated energy production and supply undertakings of one Member State from investing into ownership unbundled

energy transmission network operators of other Member States cannot be justified with public policy and security reasons or overriding interests.

Such legislation would also be likely to be in breach of the subsidiarity principle as set out in Article 5(2) EC. The exercise of the competence as conferred by Article 95 would further be disproportionate (Article 5(3) EC) to the objectives sought, which are to promote competition in an internal market for energy supply and to promote security and reliability of energy supply.

In this context, the Commission proposals confirm its role as motor of European integration when trying to enlarge the European Union's influence over the European energy industry. The Commission's activism, however, seems to have impaired its role as guardian of the EC Treaty, which also includes taking care that all European institutions live up to the rule of law and obey the protection granted by the Treaty such as the protection of fundamental rights and the guarantee of the fundamental freedoms. As an executive institution, which is at the same time part of the EC legislature in that it initiates EC legislation such as the legislation at issue here, its conduct is of questionable legality.

Not only has it produced a regulatory impact assessment, which is incomplete and wrong in places, in order to justify its proposals but it also insisted that it is mainly the separation of the energy transmission networks which would promote cross-border energy trade, although it knew at the time of its proposals that it is actually sufficient generation in the right places which is needed. This insistence probably stems from the fact that the EU does not have a competence to regulate generation, or more generally, the general structure of supply in the Member States.[1560]

As regards the issue of subsidiarity and the proportionality of the exercise of the competence of Article 95 EC, the successful evolution of (regional) cooperation and coordination of national regulatory agencies and of Transmission System Operators, in particular in the area of market coupling, has apparently not been sufficiently taken into account. The 2003 Energy Directives were also not given sufficient time to take effect before the proposal were tabled or early success has

[1560] The Commission was further misinformed when it proposed the so-called share split as a seemingly less intrusive form of legal ownership unbundling, which it actually is not. Another misconceived decision is the concession to allow vertically integrated energy transmission networks owned by public entities to be transferred from the department responsible for the vertically integrated energy supply undertaking as a whole to another department of that same public entity, which does not amount to the same degree of separation of legal ownership as required of vertically integrated energy transmission networks in private hands. The latter issue will be referred to again in section C *infra*.

simply been neglected as can be seen in the case of Germany, which as recently as summer 2005 installed a regulatory authority which has operated with ever growing success ever since.

Coming back to the issue of whether the competence to introduce further unbundling measures as proposed by the Commission can actually be exercised, it is admitted that this discussion is of a rather theoretical nature; its main aim is to contribute to the development of the interpretation of EC law. Should this ever become an issue before the ECJ, it will, however, be unlikely to be given much weight as experience has shown that competence issues rarely induce the ECJ to invalidate EC legislation under judicial review.

On the other hand, in spite of this discussion's limited practical relevance it may serve a purpose: because further unbundling legislation is such a far-reaching and substantial interference with (economic) fundamental rights and because of the energy supply industry's fundamental importance for the economic performance of the EU, the judicial review of such legislation offers a golden chance to continue to develop the effectiveness of fundamental rights protection in the European Union (see further section C below).

B. EVOLUTION, STRUCTURE AND REGULATION OF ENERGY SUPPLY SECTORS IN GERMANY, GREAT BRITAIN AND THE NETHERLANDS

It has become clear that the energy supply sectors in Germany, Great Britain and the Netherlands have developed rather distinctly and display rather diverging stages of energy network unbundling. In order to understand the differences, one first has to understand the evolution, structure and regulation of the energy supply sectors in the Member States under review here.

The Netherlands are and remain a natural gas exporting country for the time being. The Dutch energy supply industry has always been (predominantly) state-owned (i.e. including municipalities and provinces); all energy networks are state-owned and as such subject to regulation. New legislation has recently been passed ensuring that this remains the case for the time being. Only electricity generation and energy supply (retail) has been shared with the private sector for about a decade (with the major energy supply undertakings still in the hands of municipalities and provinces).[1561]

[1561] Very recently, Nuon (exclusive of its energy supply networks) was bought by Vattenfall and Essent by RWE (again without the energy supply networks); both acquisitions are still subject

The UK has only recently turned from a natural gas exporting to an importing country. The energy supply industry in England, Wales and Scotland (Great Britain) is equipped with sufficient electricity generation and was privatized some two decades ago, the electricity sector in England and Wales vertically separated *ab initio* (at least with respect to transmission) and the gas sector in Great Britain vertically integrated but separated voluntarily about a decade after privatization. Although being one of the pioneers of energy supply sector regulation in Europe, a great deal of work was needed before regulation began to work effectively (in particular in the gas sector but also in electricity wholesale). Since privatization, it has not forced further unbundling upon its energy sector except for creating an independent GB electricity transmission system operator with some influence on investment.

Germany, which compared to the Netherlands and the UK as never possessed significant natural gas resources, has always been heavily reliant on coal as primary energy source. Germany's energy supply sector has always been in private hands or in the hands of municipalities, which enjoy a certain degree of autonomy as a result of Germany's federal structure. Because of the basically private structure of the sector, Germany has never been able (unlike the Netherlands and the UK) to impose regulation or enforce rapid restructuring in the sector. Liberalization has taken almost a decade culminating in the late introduction of a sector-specific regulatory authority in July 2005, which has made considerable progress ever since (with incentive regulation to be introduced in 2009). This progress is, however, not yet reflected in the Commission's sector inquiry. In contrast to the UK, which faces vertical reintegration of energy wholesale and retail and thus tighter wholesale markets, and which is, as a result of its being (since only recently) no longer self-sufficient in energy supply, still in the process of ensuring sufficient energy supply security, Germany has only recently legislated for easier connection of generation plant to the networks (in order to promote independent generation) and has a mechanism for the promotion of renewable energy sources (RES) and combined heat power (CHP) in place, which is conducive to supply security (compare this to the UK, which has a more short-term competition orientated support mechanism in place because it only fairly recently had to start making provision for energy supply security); the four German electricity transmission operators (also owning the networks) are currently considering the creation of a national electricity transmission system operator (under club ownership).

to approval of the competition authorities. See Spiegel, 'Vattenfall kauft Nuon für 8,5 Milliarden Euro', 23 February 2009, and 'RWE will niederländischen Energiekonzern kaufen', 12 Januar 2009.

This brief factual comparison already shows why the markets of the three countries under review are structured so differently. The second distinction of primary importance for the different development in market structure is certainly the contrasting constitutional settings of Germany, the UK and the Netherlands and the differences in fundamental rights protection.

C. CONSTITUTIONAL LAW AND FUNDAMENTAL RIGHTS PROTECTION

In the UK and the Netherlands, the European Convention of Human Rights (ECHR) is in principle *the* fundamental rights standard, against which national legislation is to be measured. In the UK and the Netherlands directly applicable EC legislation is to be measured against EC fundamental rights.

The UK and the Netherlands are distinct in that the UK is a dualistic legal order whereas the Netherlands is a monistic legal order. Accordingly, in the UK the ECHR is only (to a limited extent) applicable via the HRA whereas in the Netherlands the ECHR is part of the national legal order as is, in principle, EC law.

In Germany as a dualistic legal order such as the UK, national legislation is measured against the requirements of the German Constitution (and ultimately also against the ECHR, which in the context of this work might, however, only be relevant with respect to the protection of public undertakings, see further below); directly applicable EC legislation as well as EC Directives are not measured against German constitutional law as long as they live up to a similar fundamental rights standard as is afforded by the German Constitution.[1562]

The fundamental difference between these two countries, apart from the fact that Germany possesses a codified constitution, the Grundgesetz, whereas the UK's constitutional law is not codified, is the position of the judiciary in both countries.

In the UK, the doctrine of parliamentary sovereignty has historically led to the submission of the judiciary to Parliament to the extent that Acts of Parliament

[1562] Which, by the way, is similar, from the viewpoint of the European Court of Human Rights (ECtHR) with respect to the relationship between the ECHR and EC fundamental rights protection, see in re *Bosphorus*, chapter 4 on Germany, n. 824, and chapter on 5 Great Britain, n. 1145. Both positions, i.e. the German and the ECtHR's, are in direct opposition to the ECJ's doctrine of the primacy of EC law.

are not reviewed under English law. A further consequence of this doctrine is the acceptance that fundamental rights have always been subject to unfettered interference by Parliament normally based on political bargaining. This constitutional setting has certainly been conducive to the success of UK style energy supply sector regulation. On the other hand, the British courts also act as European courts (on the basis of an authorization by Parliament); consequently, national legislation (or even directly applicable EC legislation) might ultimately land on the tables of the ECtHR.[1563]

In Germany, the Federal Constitutional Court *Bundesverfassungsgericht*, which safeguards the German Constitution and thus also reviews Acts of Parliament, has developed and enforced a rather detailed fundamental rights protection, which directly influences German style (energy supply) sector specific regulation, which focuses stricter on the rule of law than on regulatory bargaining.

The Netherlands finds itself positioned half-way between the UK and Germany in that national legislation can also be reviewed albeit only against the standard of the ECHR and not against the standard of the national constitution *Grondwet*.

Fundamental rights protection

In Germany, the analysis of the applicability of fundamental rights to further unbundling measures as proposed by the Commission, or more specifically, any possible implementation of such measures into German law, have led to the conclusion that ownership unbundling would be a disproportionate expropriation and "deep" independent system operation would be a regulation of ownership amounting to expropriation, which would also be disproportionate. The maximum possible in terms of further unbundling would be the introduction of an independent system operator model without investment decision and commissioning powers such as is currently in place in Scotland; the ITO model now contained in the draft Directives would in principle be in compliance with the German constitution if implemented.

The BVerfG would review German implementing legislation against the German Grundgesetz.

[1563] On the basis of a corresponding complaint. Such a situation might lead to a conflict for the UK as to which law to follow, i.e. the ECHR or EC law. See in greater detail chapter 5 on Great Britain.

In the UK, the complete transfer of the investment decision and commissioning powers of the two vertically integrated electricity transmission network owners in Scotland, which are to date shared with the national transmission system operator, would mean a deprivation of property in the form of a *de facto* expropriation while complete ownership unbundling would be a deprivation of property in the form of an expropriation according to Article 1 of the First Protocol of the ECHR as applied in the UK via the HRA.

The ECtHR would ultimately review English implementing legislation (and with it implicitly also the underlying EC legislation introducing further unbundling measures) against the standard of the ECHR.[1564]

In the Netherlands as the only Unitary State amongst the three EC Member States under review here, the vertical integrated energy supply undertakings wholly owned by municipalities and provinces in principle enjoy fundamental rights protection under the ECHR whereas the public shareholders do not. It has, however, been shown that any recourses to such protection would be of no avail. This is because under the ECHR, the deprivation of property in the form of (*de facto*) expropriation of the vertically integrated energy distribution networks would be unlikely to be classified as disproportionate as long as sufficient compensation is paid, which however would be of no use to the vertically integrated energy supply undertakings owned by subdivisions of the Dutch State given that such compensation would just circulate within the (Unitary) state organization.

Dutch courts review the legislation imposing the *groepsverbod* and other unbundling measures on the basis of the ECHR, and probably in a stricter manner than the ECtHR, which shows greater deference to decisions taken at Member State or local level.

Measuring the two original Commission proposals if passed in isolation against the fundamental rights protection as afforded by the ECJ, ownership unbundling is classified as a deprivation of property in the form of an expropriation and "deep" independent system operation a deprivation of property in the form of a *de facto* expropriation, both of which would be disproportionate (in particular for the reasons explained in section A above).

Further, the acceptance in the Commission proposals (and also, by the way, in the current draft Directives) that the mere transfer of publicly owned energy

[1564] Which might lead a conflict with the ECJ's interpretation of EC law. See further chapter 5 on Great Britain.

transmission networks to a part of the state organization separate from the part, which is responsible for the publicly owned vertically integrated energy supply undertaking would fulfil the unbundling requirements of the new legislation amounts to a manifest breach of the principle of equality because it would significantly disadvantage private undertakings in a comparable situation.

The ECJ would review further unbundling legislation on the basis of its own case law, which it has developed over the years.

As regards the question of whether public owners and shareholders and vertically integrated energy supply undertakings (partly) owned or controlled by public institutions such as municipalities and provinces can claim fundamental protection, one has to distinguish between the situation in Germany, that under the ECHR and that under EC law.

In the Federal Republic of Germany, it has been argued here against rather old case law of the BVerfG but on the basis of recent indications by the Court that its position might change.[1565] Accordingly, it is argued here that both municipalities, which possess a special status within the federal state organization because their institutional existence is constitutionally guaranteed, and the vertically integrated energy supply undertakings (partly) owned by them (in public and public private undertakings of public and private law) would enjoy protection of their (economic) fundamental rights under the German Constitution in the specific context of pursuing a competitive economic activity of energy supply.

Under the ECHR, it has been established that municipalities as governmental organizations according to Article 34 ECHR are not protected. It has, however, further been argued here that vertically integrated energy supply undertakings would be protected if they possess legal personality (no matter whether under public or private law) as long as their legal personality is recognized under national law and as long as they do not exercise public authority; both characteristics distinguish them from belonging to the state organization.

Consequently, should the German BVerfG refuse incorporated vertically integrated energy supply undertakings with public shareholders fundamental rights protection (although their legal personality is recognized in Germany), the ECtHR would be likely to grant such undertakings (not their public owners) a right of standing (*locus standi*).[1566]

[1565] But see, however, n. 940.

[1566] However, the ECtHR would probably not declare any further unbundling of vertically integrated energy supply networks disproportionate as long as sufficient compensation is

In the EU, fundamental rights protection solely depends on whether undertakings seeking such protection pursue an economic activity and take part in the competitive process, no matter whether they possess legal personality. Thus, public undertakings (controlled by public institutions) and private undertakings (with or without public (non-controlling) participation) are likely to enjoy protection.

The difference between the position the ECHR and EC law take on this issue consists of the fact that the former seems to be more formalistic, i.e. to put more emphasis on legal personality and the exercise of public authority in order distinguish such undertakings from the state organization. The approach under EC law, on the other hand, seems to be more functional.

When it comes to effective fundamental rights protection, it seems that the German BVerfG offers the higher standard compared to the ECtHR and in particular the ECJ.

The proportionality test as applied by the BVerfG in Germany, has been developed into a very detailed and elaborate process of balancing the various opposing interests at stake in the case of interference with fundamental rights and has been strictly and effectively applied in Germany also in the context of reviewing parliamentary legislation.

The fair balance test used by ECtHR by contrast albeit similar in structure to the proportionality test rarely considers fundamental rights interferences disproportionate, which as has been explained before seems to be attributable to two reasons: first, to date the provision of adequate compensation appears to have had a significant influence on the proportionality of state measures under review[1567] and, secondly, the Court accepts that the Member States and local authorities are usually better equipped to judge the proportionality of fundamental rights interferences of measures they enforce.

Although EC (case) law includes a proportionality test similar in structure to the test applied in Germany, on the basis of the case law under review here, of the three courts the ECJ seems to afford the least effective fundamental rights protection because it hardly ever finds fundamental rights interference

granted. In the case of Germany, this would indeed make sense, in contrast to the Netherlands, see *supra*, since compensation payable would ultimately end up with the municipal owners or shareholders, which are a distinct part of the federal state organization.

1567 As has been explained in chapter 7 on the European Union, if further unbundling measures as originally proposed by the Commission entered into force, the EU would ultimately be liable to pay such compensation.

disproportionate, particularly so in the area of economic fundamental rights such as the right to property. This approach of the ECJ to fundamental rights protection is certainly an issue of concern for German style fundamental rights protection as has been explained in the context of the review of the *Solange* case law of the BVerfG.

D. CONCLUDING REMARKS AND OUTLOOK

Further unbundling is such heavy weaponry to achieve the objective sought that it requires comprehensive justification. Such justification has, however, not be provided to date. On the contrary, economic (and technical) evidence shows that more effort should be put into promoting (independent) generation, which if done properly would even make the extension of energy transmission network interconnection less urgent, which in turn would weaken one of the main arguments put forth in favour of further unbundling.

Thus, as an in-depth justification is required to justify such heavy interference, it is not only the effectiveness of a remedy, which is important. At least equally important is its (economic) efficiency.

From a theoretical economic point of view, it indeed appears to be true that further unbundling would lead to a market structure, which comes closer to what economic theory considers an ideal market structure – at least more ideal than what is currently in place.

However, when one looks into what further unbundling does for the European energy supply markets, it has been shown that energy transmission network ownership unbundling delivers only marginal benefits for the creation of an internal and competitive energy supply market and the consumers' benefit. In addition, its benefits for increased investment are, to say the least, unclear. Security of energy supply is better served by other policies, namely by installing more (independent) generation capacity, which also has a greater impact on the development of competition than further network unbundling. What is more, further energy transmission network unbundling would, contrary to its purpose, unlevel the playing field in the European energy supply markets even further.

Looking at ownership unbundling or similar far-reaching unbundling measures enforced by competition law and by sector-specific legislation solely as regards their impact on the creation of a so-called level playing field in the European energy supply markets, breaking up incumbents by way of enforcing competition

law would put such undertakings at an irreversible competitive disadvantage compared to their peers, which somehow seems not to have been spotted by the Commission's radar. Individual break-ups would thus disturb the economic balance of the European energy supply sector, at least in the short term. Ownership unbundling in individual cases thus seems only possible, if at all, when enforced in markets, which feature one monopolist or near-monopolist (such as for instance Microsoft) or a dominant undertaking within a concentrated oligopolistic market; although vertically integrated energy transmission networks are natural monopolies, in a European context there are several "national champions", which feature such natural monopolies, which if broken up in individual cases only would lead to a disturbed economic balance as just described.

Such individual unbundling would naturally also be less effective in achieving sector-wide unbundling in order to create an internal energy supply market and sufficient competition. The competition law remedy of further network unbundling would thus for economic and sector-specific reasons not be proportionate (to the interference it causes to (economic) fundamental rights).[1568]

But further unbundling measures as envisaged by the original Commission proposals and even more by the current draft Directives, i.e. inclusive of the ITO model, also "unlevel" the level playing field. Further network unbundling is likely to intensify vertical integration of energy production and retail as can be seen in the UK and New Zealand energy supply markets. The third energy package deepens regulatory differences in the Member States; differences in energy supply market structure in the various Member States might become even greater. Further network unbundling of public and private vertically integrated energy supply undertakings carries the same label ("ownership unbundling")[1569], but could effectively mean less intrusive unbundling for public undertakings thus leading to unequal treatment of the public and private energy supply companies (and thus unequal interference with their respective economic fundamental rights), which would also affect their investment opportunities in Member States which have enforced ownership unbundling. And, as has already been indicated, if sufficient volumes of further (independent) generation capacity are not added (either on the national level where the actual competence in this respect lies or on

[1568] Instead of actively enforcing such a structural remedy, the recent E.ON and RWE cases, see n. 252 have shown that the threat of hefty fines for anti-competitive beaviour can actually also achieve the desired results.

[1569] This formally equal treatment on the remedial side reflects the one-size-fits-all or egalitarian approach taken by the current draft Directives as sector-wide regulatory measures.

the basis of the European Commission's "quasi-regulatory" competition law enforcement powers when accepting corresponding undertakings of energy supply undertakings such as recently provided by E.ON[1570]) this would also make it more unlikely that the creation of a level playing field is going to be achieved.

Thus, the economic reasons indicated above and the likelihood that further unbundling legislation will not level the playing field contribute to the disproportionality of such legislative measures (with respect to the interference with (economic) fundamental rights).

It has, however, also been shown that properly regulated TPA implemented via competition law enforcement, which may also include the connection of (independent) generation, is one of a combination of measures, which can achieve the goal of a more competitively working internal energy supply market in a proportionate way.

Another such measure is the use of its "quasi-regulatory" powers by the Commission in the area of merger control to carefully control the ever growing vertical integration of energy production and retail in the European energy supply sector.

A further such measure is the release of gas and/or electricity generation, as again shown in the late E.ON case[1571], considering that liquid energy wholesale markets or independent generation and independent import contracts (hub trading) with gas producers combined with access to gas import pipelines (pipeline capacity trade independent of gas take obligations) are actually more effective and efficient than energy transmission network ownership unbundling to achieve an internal and competitive energy supply market and also considering that the European Union does not have the competence to regulate in this area as it falls into the remit of the Member States' to regulate their national energy production sectors.

Another such measure is the tightening of the regulatory regime already in place in order to clarify ambiguities and to narrow down margins of interpretation; effective and uniform regulation in all European energy supply markets with a strict implementation of legal unbundling of energy transmission and distribution networks, which requires more time than has been allowed for the implementation of the current unbundling measures, is the *condition sine qua non* for enhanced competition in energy retail, which should be combined with stricter informational obligations bearing in mind that network monopolists do not

1570 N. 252.
1571 N. 252.

really have a need for confidentiality. Further, uniform requirements for the extension of electricity and gas transmission interconnectors in all Member States and the promotion of merchant transmission, including by way of predictable and uniform licence conditions to enhance the availability of energy throughout the European Union[1572], are another prerequisite for the development of energy supply competition in the EU. Further, stronger regional cooperation is required as envisaged by the current draft Directives including the strengthening of ERGEG.

From the analysis of the legality of further unbundling of the European energy supply industry, which includes an evaluation of its economic reasonableness, the following lessons can be learnt with respect to the development of fundamental rights protection in the European Union and the cross-fertilization[1573] resulting from the introduction of further unbundling measures in the European Union and its Member States.

First, contrary to the belief of the European Commission, the imposition of further unbundling measures on the European energy supply industry with such far-reaching consequences for the (economic) fundamental rights of the intended targets of such measures cannot be done by simply disregarding the common constitutional traditions of the Member States or merely assuming the application of the "lowest common denominator" of fundamental rights protection. On the contrary, the European Commission as motor and guardian of the EC Treaty should not only be committed to establishing a competitive internal market but also to respecting the common constitutional traditions of the Member States.

Secondly, further unbundling legislation is passed by a legislature, which consists of a Council of 27 Member States' government ministers, which is mainly involved in political bargaining and often whose members are often rather detached from the control of their national parliaments, and by the European Parliament which naturally has a clear focus on EC objectives but no great concern for defending the subsidiarity principle.

It is against this background that the ECJ should *effectively* develop and enforce a fundamental rights standard in the European Union[1574], which is based on the

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1572 See n. 158 as regards principal differences in licensing and authorization operations in the Member States and in particular in the three countries under review here.

1573 See n. 1577.

1574 It has already been pointed out that the ECJ is likely to be lenient on the question of *whether* a competency of the EU can be exercised. The Court should, however, become more vigilant as regards *how* such competency is exercised thus helping fundamental rights protection to achieve its *effet utile*.

common constitutional traditions of the Member States.[1575] As the "constitutional" court of the European Union with corresponding judicial powers, which are supposed to ensure the compliance of EU institutions with EC law including EC fundamental rights, its role is more akin to that of national courts than to that of the ECtHR.[1576]

The ECtHR lacks judicial powers such as the ECJ possesses and thus has to rely on the cooperation of the Convention's signatory countries. Although it rightly defers to the wide margin of appreciation of the national governments as regards the legitimacy of the objectives of measures which interfere with the fundamental rights as guaranteed by the ECHR, it nevertheless applies the proportionality principle to restrict and control the margin so granted. It does so with the aim of developing a European fundamental rights standard even though it does not have the means the ECJ has at its disposal.

The reluctance of the ECJ to *effectively* enforce the rule of law and thus also fundamental rights protection in the European Union is unfortunate, in particular considering the rather questionable conduct of the Commission and the very reduced democratic legitimacy of the Council acting as the main EC legislative institution.

Effective fundamental rights protection by the ECJ would in turn enhance the national acceptance of the *supra*-national legal order, which would in turn enhance the democratic functioning of the EU, and would encourage greater cooperation at EU level with respect to the completion of the internal market.[1577]

1575 EC fundamental rights must necessarily be different (at least as regards the way in which they are protected and any possible limitations to these rights) from the fundamental rights as protected at Member State level, which are limited to the area and reach of the Member States' sovereignty. More important is the methodology and structure of protection applied by the European courts, in particular as regards the application of the proportionality principle as well as the procedural enforceability of fundamental rights.

1576 The European legislature is split into a European Parliament and the Council of the Member States' governments (consisting of the executive organs of the Member States), which is similar to the federal structure of Germany (*Bundestag* and *Bundesrat*, the latter of which also consists of representatives of the executive organs of the *Länder*). What is different though is that unlike in Germany the Council enjoys dominance, which makes judicial supervision even more urgent than in Germany.

1577 As theoretic underpinning for this interdependency, *van Gerven* has developed the so-called cross-fertilization model, see W van Gerven, 'Mutual Permeation of Public and Private Law at the National and Supranational Level', (1998) MJ 7, and High Level Group (chaired by W Kok), 'Facing the Challenge – the Lisbon strategy for growth and employment', Report, November 2004, p. 41. According to this model, the laws of the Member States feed into the development of EC law, which in this case means the common constitutional traditions of the Members States as regards the effective protection of fundamental rights. In turn, EC law infiltrates the national laws of the Member States, leading to changes within these legal sytems. The national

It would further secure the rule of law at EC level by restraining political bargaining, which is sometimes far removed from its democratic foundations. It would also make the Commission and the Parliament aware of their role in not only guarding the Treaty's objective to of constructing the internal market but also the Treaty's other objective, which is to respect common constitutional traditions.

Similar to the significant influence which the UK approach to energy supply sector regulation has had on EC energy supply sector regulation, the German approach to a structured (economic) fundamental rights protection should significantly assist the EU in making its approach to fundamental rights protection more robust and effective.

As EC law establishes an ever growing integration of the national (energy supply) markets, the application of national standards of fundamental rights protection and the interpretation of the boundaries of EC competences and their exercise should lead to an ever improving level of fundamental rights protection and European integration, which in turn should result in an ever growing support for the assumption and exercise of competences by the EU.[1578]

application of EC law leads to new insights in terms of law and its application, and with regard to policy choices, which in the current case would include the acceptance of the fact that energy supply has become an issue with a European dimension, which is to be conducted in a secure and competitive manner throughout the European Union. The experience of Member States feeds again into EC law to refine it further, such as through ever growing regulatory coordination and cooperation. This is a dynamic process theoretically leading to an increased quality in the law, both in terms of effectiveness and of policy.

1578 See in this respect also Di Fabio, n. 539. On 30 June 2009, the BVerfG (2 BvE 2/08, 5/08, 1010/08, 1022/08, 1259/08, 182/09) ruled that although the ratification of the Lisbon Treaty is compliant with the GG, a parliamentary law accompanying the ratification, which sets out the rights of paricipation of the German federal legislature in the European legislative process, is not in that it does not sufficiently allow for (national) palriamentary control of such process. The Court establishes that the Lisbon Treaty leads to a further and far-reaching transfer of competences to the European Union; the detachment of the decision making process from national legislative participation thus requries an effective *ultra vires* control of European legislative acts when applied in the jurisdiction of Germany.

SAMENVATTING

Dit werk geeft een analyse van de rechtsgeldigheid van op basis van Europese economische reguleringsbevoegdheden toe te passen (dreigende) maatregelen tot ontvlechting van energieleveringsnetwerken en analyseert in het bijzonder of deze maatregelen in strijd zijn met in Duitsland, Groot-Brittannië, Nederland en de Europese Unie beschermde fundamentele economische rechten.

A. EG-BEVOEGDHEDEN OP HET GEBIED VAN MEDEDINGINGSRECHT EN SECTOR-REGULERING

Het opleggen van splitsing van verticaal geïntegreerde energieleveringsnetwerken op basis van de mededingingsrechtelijke handhavingsbevoegdheden van de Commissie staat niet in verhouding tot het beoogde doel, namelijk het herstel van mededinging in een interne energieleveringsmarkt. Ontvlechting of splitsing van eigendom en onafhankelijk systeembeheer ("*deep independent system operation*" of "*deep ISO*", waarbij de systeembeheerders exclusieve bevoegdheden tot investeringen en aanbesteden krijgen) van energieleveringsnetwerken zal geen of hooguit een marginaal voordeel opleveren voor de consumentenwelvaarticle Voor wat betreft elektriciteit hangt dat voordeel hoofdzakelijk samen met voldoende opwekking. Met betrekking tot gas is in dit onderzoek bewezen dat regulering in combinatie met mededingingsrechthandhaving voldoende is.

Met betrekking tot (nieuwe) EG-wetgeving, ervan uitgaande dat deze rechtsgeldig is gebaseerd op artikel 95 van het EG-verdrag, is de Europese wetgever beperkt in de uitvoering van deze bevoegdheid op grond van artikel 295 van het EG-vedrag. Bovendien zou het fundamentele recht van het vrij verkeer van kapitaal op basis van Artikel 56 van het EG-verdrag in gevaar komen.

B. DE ONTWIKKELING VAN DE ENERGIE-LEVERINGSSECTOR IN DUITSLAND, GROOT-BRITTANNIË EN NEDERLAND

De energieleveringssectoren in Duitsland, Groot-Brittannië en Nederland hebben zich ieder afzonderlijk ontwikkeld en vertonen grote verschillen op het gebied van ontvlechting van energienetwerken.

Nederland is een exporteur van aardgas en zal dit voorlopig ook blijven. De Nederlandse energieleveringsindustrie is van oudsher (hoofdzakelijk) in handen van de Staat. Recent aangenomen nieuwe wetgeving garandeert dat dit met betrekking tot de Nederlandse energieleveringsnetwerken voorlopig zo zal blijven.

Het Verenigd Koninkrijk is pas recent veranderd van een exporteur van aardgas in een importeur daarvan. De energieleveringsindustrie in Groot-Brittannië heeft voldoende opwekkingsvermogen voor elektriciteit en is circa 20 jaar geleden geprivatiseerd, waarbij de elektriciteitssector in Engeland en Wales vanaf het begin verticaal werd gescheiden (in ieder geval met betrekking tot transmissie) en de gassector in Groot-Brittannië verticaal was geïntegreerd, maar circa tien jaar na de privatisering vrijwillig werd gescheiden. Sinds de privatisering heeft zich geen andere grote ontvlechting meer voorgedaan, behalve dan dat een onafhankelijke elektriciteit-transmissiesysteembeheerder voor Groot-Brittannië met enige invloed op investeringen is opgezet.

Duitsland is van oudsher in overwegende mate afhankelijk geweest van steenkool als primaire energiebron en de in grote mate verticaal geïntegreerde energieleveringssector is in particuliere handen of in handen van gemeenten.

C. CONSTITUTIONEEL RECHT EN BESCHERMING VAN GRONDRECHTEN

De verschillen in ontwikkeling van de marktstructuren zijn ook het gevolg van de verschillende constitutionele kaders in Duitsland, het Verenigd Koninkrijk en Nederland, evenals van de verschillende wijzen van bescherming van grondrechten.

In het Verenigd Koninkrijk en Nederland is het Europees Verdrag tot bescherming van de rechten van de mens en de fundamentele vrijheden (EVRM) in principe *de* standaard voor grondrechten waar nationale wetgeving aan getoetst dient

te worden. In het Verenigd Koninkrijk en Nederland dient rechtstreeks toepasselijke EG-wetgeving getoetst te worden aan EG-grondrechten.

In Duitsland wordt nationale wetgeving getoetst aan de vereisten van de Duitse Grondwet. Rechtstreeks toepasselijke EG-wetgeving en EG-richtlijnen worden niet getoetst aan Duits constitutioneel recht, zolang op Europees niveau een gelijkwaardige grondrechtenbescherming wordt geboden als in de Duitse Grondwet.

In het Verenigd Koninkrijk heeft de doctrine van parlementaire soevereiniteit geleid tot de onderwerping van de rechterlijke macht aan het Parlement in die zin dat wetten niet worden getoetst onder Engels recht. Een andere consequentie van deze doctrine is de aanvaarding dat grondrechten altijd onderworpen zijn geweest aan vrije inmenging door het Parlement, welke inmenging gewoonlijk wordt gebaseerd op politieke onderhandelingen. Dit grondwettelijke kader heeft zeker bijgedragen aan het succes van de regulering van de energieleveringssector in het Verenigd Koninkrijk.

In Duitsland heeft het federale constitutionele Hof, het zogenaamde *Bundesverfassungsgericht,* dat ook wetten toetst, een zeer gedetailleerde bescherming van grondrechten ontwikkeld en toegepast, die van directe invloed is op de Duitse sectorgerichte regulering en meer de nadruk legt op de letter van de wet dan op regulerende onderhandelingen.

Nederland bevindt zich tussen het Verenigd Koninkrijk en Duitsland in: de nationale wetgeving kan door de rechter getoetst worden, zij het alleen aan de EVRM-standaard en niet aan de nationale Grondwet.

In Duitsland zou de implementatie van eigendomsontvlechting een disproportionele onteigening zijn en zou onafhankelijk systeembeheer ("*deep ISO*") een regulering van eigendom zijn die zou neerkomen op onteigening, wat ook disproportioneel zou zijn.

In het Verenigd Koninkrijk zou de volledige overgang van de bevoegdheden tot investering en aanbesteding van de eigenaren van de twee verticaal geïntegreerde elektriciteitstransmissienetwerken in Schotland een ontneming van eigendom betekenen in de vorm van een *feitelijke* onteigening, terwijl volledige eigendomsontvlechting een eigendomsontneming zou zijn in de vorm van een onteigening.

In Nederland genieten de verticaal geïntegreerde energieleveringsondernemingen die volledig eigendom zijn van gemeenten en provincies in principe bescherming

van grondrechten op basis van het EVRM, in tegenstelling tot hun publieke aandeelhouders. Eigendomsontneming in de vorm van een (feitelijke) onteigening van de verticaal geïntegreerde energiedistributienetwerken zal naar alle waarschijnlijkheid niet als disproportioneel worden aangemerkt zolang voldoende vergoeding wordt betaald; dit is echter niet zinvol voor de verticaal geïntegreerde energieleveringsondernemingen die eigendom zijn van lichamen van de Nederlandse Staat, aangezien een dergelijke vergoeding slechts zou gaan circuleren binnen het staatsapparaat.

Bij de toetsing van verdere ontvlechtingsmaatregelen aan de bescherming van grondrechten zoals verschaft door het Europese Hof van Justitie, wordt eigendomsontvlechting aangemerkt als eigendomsontneming in de vorm van een onteigening en wordt onafhankelijk systeembeheer ("deep ISO") aangemerkt als eigendomsontneming in de vorm van een *feitelijke* onteigening; beiden zijn disproportioneel.

De aanvaarding dat met de enkele overgang van de in staatseigendom zijnde energietransmissienetwerken naar een onderdeel van de staatsorganisatie dat afgescheiden is van het deel dat verantwoordelijk is voor de verticaal geïntegreerde energieleveringsonderneming voldaan zou zijn aan de ontvlechtingsvereisten van de nieuwe EG-wetgeving, komt neer op een manifeste inbreuk op het gelijkheidsprincipe, aangezien particuliere ondernemingen hier aanzienlijk door benadeeld zouden worden.

Voor wat betreft de vraag of publieke eigenaren en aandeelhouders alsmede verticaal geïntegreerde energieleveringsondernemingen die (deels) eigendom zijn van of gecontroleerd worden door publieke instellingen zoals gemeenten en provincies een beroep kunnen doen op grondwettelijke bescherming, dient voor wat betreft Duitsland een onderscheid gemaakt te worden tussen de situatie naar EVRM-maatstaven en naar EG-recht.

In Duitsland wordt geargumenteerd dat zowel gemeenten, die een zekere mate van autonomie hebben als gevolg van de Duitse federale structuur, als de verticaal geïntegreerde energieleveringsondernemingen die (deels) eigendom zijn van deze gemeenten bescherming zouden genieten van hun (economische) grondrechten onder de Duitse Grondwet in de specifieke context van het nastreven van een concurrerende economische energieleveringsactiviteit.

Onder het EVRM is vastgesteld dat gemeenten, als zijnde overheidsorganisaties, niet worden beschermd op basis van Artikel 34 EVRM. Er wordt hier echter verder beredeneerd dat verticaal geïntegreerde energieleveringsondernemingen

beschermd zouden zijn wanneer zij rechtspersoonlijkheid zouden bezitten, zolang een dergelijke rechtspersoonlijkheid wordt erkend door nationaal recht en zolang zij geen publieke bevoegdheden uitoefenen.

In de EU hangt bescherming van grondrechten slechts af van de vraag in hoeverre ondernemingen die een dergelijke bescherming nastreven een economische activiteit uitoefenen en deelnemen aan het concurrentieproces, ongeacht of zij rechtspersoonlijkheid bezitten. Daarom is het waarschijnlijk dat publieke en particuliere ondernemingen bescherming zullen genieten.

Voor wat betreft effectieve bescherming van grondrechten, lijkt het Duitse Bundesverfassungsgericht een hogere standaard te bieden dan het Europees Hof van de Rechten van de Mens en in het bijzonder het Europese Hof van Justitie.

De proportionaliteitstoets zoals toegepast door het Bundesverfassungsgericht in Duitsland heeft zich ontwikkeld tot een zeer gedetailleerde en uitvoerige procedure van afweging van de verschillende tegengestelde belangen die aan de orde zijn in geval van vermeende schending van grondrechten en wordt ook in de context van toetsing van parlementaire wetgeving nauwkeurig en effectief toegepast.

De fair balance-test die wordt toegepast door het Europees Hof van de Rechten van de Mens in plaats van de proportionaliteitstoets, ofschoon beide gelijksoortig in structuur zijn, beschouwt inmenging in grondrechten zelden als disproportioneel, waarvoor twee redenen lijken te zijn: ten eerste blijkt het verschaffen van voldoende vergoeding tot op heden een aanzienlijke invloed gehad te hebben op de proportionaliteit van de getoetste staatsmaatregelen en ten tweede accepteert het Hof dat de Lidstaten en lokale autoriteiten meestal beter in staat zijn een oordeel te vellen met betrekking tot de mate van proportionaliteit van grondrechtenschendingen die worden veroorzaakt door hun eigen maatregelen.

Hoewel EG-recht en EG-jurisprudentie een proportionaliteitstoets inhouden die qua structuur gelijksoortig is aan de toets die wordt toegepast in Duitsland, lijkt op basis van de in deze studie getoetste jurisprudentie het Europese Hof van Justitie de minst effectieve grondrechtenbescherming te bieden van de drie gerechten, aangezien het slechts zelden oordeelt dat een inbreuk op grondrechten disproportioneel is.

D. CONCLUSIES EN VERWACHTINGEN

Economisch (en technisch) bewijs laat zien dat er meer inspanningen verricht zouden moeten worden ter bevordering van opwekking, wat - indien optimaal uitgevoerd- de uitbreiding van interconnectie van energietransmissienetwerken minder urgent maakt, als gevolg waarvan één van de hoofdargumenten voor verdere ontvlechting wordt verzwakt.

Eigendomsontvlechting van energietransmissienetwerken levert voor de ontwikkeling van een interne en concurrerende energieleveringsmarkt en dus voor de consument slechts marginale voordelen op. Bovendien is het nut daarvan met betrekking tot verhoogde investeringen op zijn zachtst gezegd onduidelijk. Betrouwbaarheid van energielevering is meer gebaat bij ander beleid, namelijk door de installatie van meer opwekkingscapaciteit, wat een grotere invloed heeft op de ontwikkeling van concurrentie dan verdere ontvlechting van netwerken. Daar komt nog bij dat verdere ontvlechting van energietransmissienetwerken, in strijd met het beoogde doel, de Europese energieleveringsmarkt nog meer uit balans zal brengen.

Verdere ontvlechtingsmaatregelen zullen waarschijnlijk een intensivering tot gevolg hebben van de verticale integratie van productie en detailhandel op het gebied van energie. Het derde energiepakket zal de verschillen in regulering in de Lidstaten vergroten; ook de verschillen in structuur van de energieleveringsmarkten in de Lidstaten kunnen toenemen. Verdere netwerkontvlechtingen van publieke en particuliere verticaal geïntegreerde energieleveringsondernemingen worden weliswaar aangeduid onder dezelfde naam ("eigendomsontvlechting"), maar zouden in de praktijk minder indringend kunnen zijn voor publieke ondernemingen; dit resulteert in ongelijke behandeling van de publieke en de particuliere energieleveringsbedrijven en levert daarmee een ongelijke inbreuk op hun respectievelijke economische grondrechten op; ook zou dit hun investeringsmogelijkheden kunnen aantasten in Lidstaten die eigendomsontvlechting hebben opgelegd.

Er is in dit onderzoek echter aangetoond dat behoorlijk gereguleerde toegang van derden ("*Third Party Access*"), geïmplementeerd door middel van mededingingsrecht, welke ook de verbinding van opwekking zou kunnen omvatten, één maatregel is uit een pakket waarmee het doel van een meer concurrerend werkende interne energieleveringsmarkt op evenredige wijze kan worden bereikt.

Een dergelijke maatregel is ook het vrijgeven van gas- en/of elektriciteitsopwekking, evenals het aanscherpen van het reeds bestaande reguleringsregime, zodat onduidelijkheden worden opgehelderd en marges voor interpretaties worden verkleind. Uniforme vereisten voor de uitbreiding van interconnectoren voor elektriciteits- en gastransmissie in alle Lidstaten en het stimuleren van transmissie door derden (*merchant transmission*) zijn een ander noodzakelijke voorwaarde voor de ontwikkeling van concurrentie op het gebied van energielevering in de EU. Tenslotte is sterkere regionale samenwerking gewenst zoals omschreven in de huidige Ontwerprichtlijnen, waaronder de versterking van de ERGEG (*European Regulator's Group for Electricity and Gas*).

Het opleggen van verdere ontvlechtingsmaatregelen aan de Europese energieleveringsindustrie met zulke ingrijpende gevolgen voor de (economische) grondrechten van de door dergelijke maatregelen getroffen partijen kan niet uitgevoerd worden als daardoor de gemeenschappelijk grondwettelijke tradities van de Lidstaten simpelweg worden genegeerd of slechts de laagste gemeenschappelijke noemer op het gebied van bescherming van grondrechten wordt toegepast.

Het Europese Hof van Justitie zou een standaard voor grondrechten in de EU moeten ontwikkelen en toepassen die is gebaseerd op de gemeenschappelijke grondwettelijke tradities van de Lidstaten. Als zijnde het constitutionele Hof van de Europese Unie met bijbehorende gerechtelijke bevoegdheden, die geacht worden de nakoming door de EU-instellingen van EG-recht inclusief de EG-grondrechten te verzekeren, lijkt de rol van dit Hof echter meer op die van de nationale rechtbanken dan op die van het Europees Hof van de Rechten van de Mens.

Effectieve bescherming van grondrechten door het Europese Hof van Justitie zou bovendien de nationale acceptatie bevorderen van de supranationale rechtsorde, waardoor op haar beurt het democratisch functioneren van de EU wordt bevorderd en tevens meer samenwerking op EU-niveau wordt gestimuleerd om de interne markt te voltooien. Het zou de rechtsstaatgedachte op EG-niveau zeker stellen door het beperken van onderhandelingen op politiek niveau, wat soms weinig meer te maken heeft met de democratische fundamenten daarvan. Het zou tevens de Commissie en het Parlement meer bewust maken van het feit dat zij niet alleen bewakers zijn van het doel om een interne markt op te zetten, maar ook van een ander doel van het Verdrag, namelijk het respecteren van gemeenschappelijke grondwettelijke tradities.

De benadering in het Verenigd Koninkrijk met betrekking tot de regulering van haar energieleveringssector heeft aanzienlijke invloed gehad op de Europese regulering van de energieleveringssector. Op diezelfde manier zou de Duitse benadering met betrekking tot de gestructureerde bescherming van (economische) grondrechten aanzienlijk kunnen bijdragen aan het versterken en effectiever maken van de Europese aanpak van de bescherming van grondrechten in de EU.

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GERMANY

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